ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

Expert Panel on Equalization and Territorial Formula Financing

May 2006

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May 2006

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance
House of Commons
Ottawa, Ontario

Dear Minister,

We are pleased to provide the report and recommendations of the Expert Panel established to review Territorial Formula Financing (TFF).

For the past year, Panel members have listened to the views of territorial governments and people in the North. We have learned about the unique challenges and circumstances in the territories and their aspirations for self-sufficiency. Clearly, Territorial Formula Financing is critical for the territories and, while there is tremendous potential for economic development in the North, TFF will remain an essential program for the territories for years to come.

We have analyzed a wide range of ideas and options for Territorial Formula Financing, explored alternatives and assessed the impact. We believe that the package of recommendations outlined in our report will provide a significant improvement over the current arrangements and establish a solid new approach for the future of Territorial Formula Financing.

We would like to thank the territorial governments, federal government officials, and a host of people in the North who contributed to our review. We hope our report reflects the aspirations and expectations of people in the territories and most important, that it helps secure a stronger future for the territories.

Yours sincerely,

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University of Alberta

Fred Gorbet
Principal, Strategy Solutions

Robert Lacroix
Founding member, Centre for Interuniversity Research
and Analysis on Organization (CIRANO)

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EXECUTIVE SUMMARY

Achieving a national purpose

"The current fiscal fragility of the north is a leading indicator of a future greatly in need of immediate attention. Clearly, the north is very much in transition. There is a necessity to invest in the north if it is ever to achieve the self-sufficiency anticipated by the original objectives of the formula financing arrangements between Canada and the territories."

Government of the Northwest Territories,
Government of Nunavut, Government of Yukon[1]

Those words, written in 2003, certainly ring true today.

As part of its review of Territorial Formula Financing (TFF), the Expert Panel on Equalization and Territorial Formula Financing (the Panel) was struck by a number of key points.

- The situation in Canada's territories is vastly different from the challenges faced by the provinces. Communities are small and isolated. Costs are substantially higher. Although economic diversification is currently limited, there are significant opportunities for resource development.
- Although the three territories share common aspirations and dreams for the North, there are substantial differences among the three territories that call into question the effectiveness of one-size-fits-all solutions.
- All three territories rely heavily on TFF and other federal transfers to pay for essential public services. In 2005–06, TFF made up between 64 and 81 percent of territorial budgetary revenues.[2]
- A number of indicators point to serious health and social problems combined with lower health and education outcomes, inadequate housing, and an urgent need to replace and expand existing infrastructure. Although there are challenges in all three territories, the situation in Nunavut is particularly serious.
- There is great potential for economic development from natural resources in the territories; however, there are significant financial and social costs involved. Additional investment is needed to address these costs and achieve the territories' fiscal, economic, and social potential.

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1 Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2003). *Territorial Business Case: Joint Paper on Fiscal Issues*, p. 3.

2 This percentage is based on 2005–06 Revised Estimates provided by the three territories in their 2006–07 budgets.

- The territories' determination to become self-sufficient and self-reliant is an important priority for Canada. Changes to TFF should support the territories in achieving their goal of self-sufficiency.

These points provide an important backdrop for the Panel's report and recommendations. They underscore the reason why TFF is distinctly different from the Equalization program in approach, in objectives, and in design. Because of the significant differences in the two programs, the Panel has chosen to devote a separate report to TFF issues and recommendations.

Issues and ideas

The territories' determination to become self-sufficient and self-reliant is an important priority for Canada. Changes to TFF should support the territories in achieving their goal of self-sufficiency.

Canadians have long been committed to the concept of sharing and the idea that, no matter where people live, their children should have reasonably comparable opportunities to get a good education. They should have comparable health care, social services, and other essential public services. And they should pay for those services with reasonably comparable levels of taxes.

TFF has been in place since 1985–86. Although it has been through a number of modifications, the basic idea underlying the program is that a federal grant helps fill the gap between the amount of money a territory needs to allow it to provide "reasonably comparable" public services and the amount of revenue it can raise from a combination of taxes and other sources of funds. When the program was first established, the amount of funding provided through TFF was considered adequate to meet expenditure requirements in the territories.

As part of its consultations about TFF, the Panel heard about a number of issues related to how TFF works today and ideas about how it could be improved. Key issues focused on:

- The adequacy of TFF in meeting unique needs in the territories and the clear message that current funding levels, even with the funding increases in the past two years, are not sufficient to meet their needs or reflect substantially higher costs, particularly in Nunavut.
- A recognition that, although the territories have similarities and similar challenges, they are distinct, with different circumstances, and they should be treated in comparable but separate ways.
- The importance of self-sufficiency and economic development in the territories and ensuring that TFF supports both of these goals.

- The negative impact of the New Framework introduced in October 2004 and the idea of a fixed pool on relationships among the territories.
- The need to make TFF more simple and transparent, thereby improving accountability to Canadians.
- The importance of making TFF flexible enough to accommodate agreements on Land Claims, Aboriginal self-government and devolution and resource revenue sharing.

A new approach to Territorial Formula Financing

The Panel considered all the ideas and options presented during its consultation process and developed a comprehensive new approach to TFF. The Panel's recommendations are:

1. **Replace the fixed pool under the New Framework with a formula-driven approach, providing three separate gap-filling grants to the territories.**
   While a legislated, fixed pool provides greater financial certainty for the federal government and a predictable and growing source of funds for the territories, the downside impact on the territories outweighs the benefits. It's important to have a program that reflects the differences among the territories and fills the gap between their expenditure needs and their own fiscal capacity.

It's important to have a program that reflects the differences among the territories and fills the gap between their expenditure needs and their own fiscal capacity.

2. **Address concerns with the adequacy of Territorial Formula Financing through an adjustment to the Gross Expenditure Bases for each of the territories to create New Operating Bases.**
   The Panel recommends that the current Gross Expenditure Bases (GEBs) for the territories be adjusted to reflect the 2005–06 New Framework funding levels for TFF. The Panel also recommends that these adjusted bases be renamed the New Operating Bases.
3. **Simplify the TFF formula by measuring revenue capacity using a Representative Tax System (RTS).**
   Using a Representative Tax System (RTS) approach simplifies the process, eliminates many of the previous adjustment factors, and is preferable to broader macro measures. The contentious tax effort adjustment factor would also be eliminated. It provides reasonable comparability among the territories and also adds administrative simplicity, greater transparency, and sound incentives.

4. **Further simplify the measurement of revenue capacity by establishing a Revenue Block that includes seven of the largest own-source revenues for the territories.**
   Seven tax bases should be used to determine the territories' fiscal capacity: personal income tax, corporate income tax, payroll tax, gas and diesel, tobacco, and alcohol tax revenues. This not only simplifies the formula, but also covers up to two-thirds of the territories' own sources of revenues.

5. **Improve the incentives for the territories to raise their own revenues by including only 70 percent of territories' measured revenue capacity in the formula.**
   Economic development is crucial to the future of the territories. Under this recommendation, the territories would be able to keep more of the financial benefits of economic development without seeing a corresponding drop in TFF funding.

6. **Exclude resource revenues from the calculation of revenues included in Territorial Formula Financing.**
   Unlike the provinces, the authority for developing and managing natural resource developments in the territories lies with the federal government. Since the 1980s, the Government of Canada has been engaged in discussions to devolve this authority to the territories. In principle, the Panel believes that, just like the provinces, the territories should see direct benefits from the development of resources in the territories. Each of the territories is in a different stage of discussions regarding devolution and resource revenue sharing. Yukon is the only territory with an agreement in place. Excluding resource revenues provides the flexibility necessary to accommodate future agreements and support resource development in the territories.

7. **Use the New Operating Bases as approximate measures of expenditure needs.**
   The Panel saw no evidence to suggest that the New Operating Bases, adjusted on an annual basis, aren't an adequate approximation of expenditure needs in the territories. While several suggestions were made on how to develop comprehensive measures of expenditure needs and costs in the territories, the Panel believes this would be a complex and extensive process and may not result in a better approximation than the recommended New Operating Bases.

8. **Undertake a review of significant expenditure needs and higher costs of providing public services in Nunavut.**
While the Panel does not recommend an extensive study of expenditure needs in the territories, the case for assessing expenditure needs and higher costs of delivering public services in Nunavut is substantially different. Compared with the rest of Canada, initial evidence points to serious disparities in outcomes for health, education, and social well-being in addition to an urgent need for adequate housing. The Panel's recommendations for adjusting the funding bases for TFF and providing annual escalators are designed to address the adequacy of TFF for the territories. However, these adjustments are not sufficient to address the challenges and gaps in Nunavut. The Panel recommends that more work be done to assess expenditure needs in Nunavut as a starting point for addressing those needs on an urgent basis. The review should be done jointly by the Government of Nunavut and the Government of Canada. Any additional funding necessary to address Nunavut's needs should be provided through targeted programs rather than through adjustments to the TFF formula.

9. **Adjust the New Operating Bases annually by the relative growth in population in the territories and growth in provincial and local spending (PAGE).**
Instead of escalating the total amount of TFF by a set percentage of 3.5 percent (as is now the case with the New Framework), the Panel recommends returning to the Population-Adjusted Gross Expenditure (PAGE) escalator that takes into account comparable growth in spending in the provinces as well as relative changes in territorial population compared with the rest of Canada.

Continuing the current approach with a legislated TFF program, and mechanisms for Parliamentary review, is a better match for Canada's federation.

10. **Improve stability and predictability by using three-year moving averages.**
Without a fixed pool, there can be substantial year-over-year changes in TFF entitlements. Using three-year averages smoothes out those changes and provides more stability to both the federal and territorial governments.

11. **Address issues of governance, accountability, dispute resolution, and renewal through an expanded and more transparent process.**
The Panel does not support the idea of establishing a separate, independent permanent commission to address TFF issues. Continuing the current approach with a legislated TFF program, expanded accountability, annual reporting requirements, and mechanisms for Parliamentary review, is a better match for Canada's federation. It also should provide a more open process where issues involving both the territories and the federal government can be identified and addressed.

Benefits of the Panel's new approach

- The new approach reflects eight principles including: responsibility and accountability, adequacy and comparability, affordability, predictability, neutrality, stability, flexibility, and sound incentives.
- There is a clearer incentive for territories to increase their own sources of revenues. This supports the shared goals of self-sufficiency and self-reliance and will benefit all Canadians.
- The Panel's new approach means more funding for TFF. Based on some initial indicators, additional funding is required for the territories to meet pressing needs in key program areas and to achieve the goal of providing reasonably comparable services. The Panel urges territorial governments to continue to seek the most efficient and appropriate ways of providing essential services and, at the same time, managing growing costs of public services.
- It addresses the recent sources of conflict between the federal government and the territories and provides a number of significant improvements to a formula-based approach for TFF.

The simplified TFF has a number of added benefits including a clearer understanding of the financial circumstances of the territories and more certainty for potential investors. In turn, this should support economic development in the North and help secure Canada's sovereignty over the Arctic.

- It continues to recognize the very real diversity among the territories. It builds on the positive elements of TFF and includes a separate gap-filling formula and specific escalator for each territory.
- The proposed approach to governance should bring more accountability, transparency, visibility, and timeliness to negotiations and to the renewal process for TFF.
- While it's still complex, the program is simpler than the previous TFF formula and will reduce some of the administrative burden on both the territorial and federal governments.
- The Panel's new approach is flexible enough to accommodate adjustments to funding due to federal initiatives and program transfers, existing and future agreements arising from Land Claims and Aboriginal self-government, as well as devolution and resource revenue sharing agreements among the territories, First Nations, Aboriginal organizations, and the federal government.
- The simplified TFF has a number of added benefits including a clearer understanding of the financial circumstances of the territories and more certainty for potential investors. In turn, this should support economic development in the North and help secure Canada's sovereignty over the Arctic.

Assessing the financial impact

The Panel's new approach provides more funding to the territories than they currently receive under the New Framework.

- Under the legislated New Framework, total TFF funding is $2.14 billion in 2007–08. In 2007–08, the Panel's new approach means an additional $60 million for the territories.
- Over five years, from 2005–06 to 2009–10, the Panel's approach would provide an additional $285 million more than the legislated New Framework. To put that in perspective, the Panel's approach would result in a 20 percent increase in total funding for TFF over five years, while the New Framework would result in a 15 percent increase.
- In 2007–08, each of the territories would receive additional funding under the Panel's approach compared with the TFF entitlements for 2006–07 announced by the federal Minister of Finance in November 2005. On a per capita basis, the Panel's approach translates into $18,148 per capita in the Northwest Territories, $29,165 per capita in Nunavut, and $17,114 per capita in Yukon.
- Under the Panel's approach, total funding for TFF would also be higher than under the previous TFF formula and each territory would receive more funding than under the previous TFF formula.

The Panel's approach provides more funding to the territories than they currently receive under the New Framework.

Comparison of the Panel's Approach with the New Framework, 2005–06 to 2009–10

	$ million					
	2005–06	**2006–07**	**2007–08**	**2008–09**	**2009–10**	**Total**
Panel's Approach	2,000	2,098	2,203	2,304	2,406	**11,011**
New Framework	2,000	2,070	2,143	2,218	2,295	**10,726**
Difference	0	28	60	86	111	**285**

Comparison of the Panel's Approach for 2007–08 with Announced Entitlements for 2006–07, by Territory

	$ million / $ per capita		
	Northwest Territories	**Nunavut**	**Yukon**
Panel's Approach for 2007–08			
Total Entitlements	791	880	532
Per Capita Entitlements	18,148	29,165	17,114
Announced Entitlements for 2006–07			
Total Entitlements	738	827	506
Per Capita Entitlements	17,107	27,617	16,335
Difference			
Total Entitlements	***53***	***53***	***26***
Per Capita Entitlements	***1,041***	***1,548***	***779***

Note: TFF entitlements for 2006–07 were announced by the federal Minister of Finance in November 2005, based on October 2005 data.

"We are now at our last frontier. It is a frontier that all of us have read about, but few of us have seen. Profound issues, touching our deepest concerns as a nation, await us here."

- Mr. Justice Thomas R. Berger[3]

Concluding comments

Throughout the review of TFF, the Panel learned a great deal about the territories and about issues important to northerners and their governments. We heard about the hopes and dreams of the territories to achieve self-sufficiency and to reduce their dependence on federal transfers. We heard about the potential for economic development and the sense that the territories are on the verge of major change. And, we heard that the North is essential to Canadian sovereignty and security.

At the same time, we heard serious concerns about outcomes in education and health, about social conditions and housing, aging infrastructure, high costs, and the challenges of addressing those concerns in the unique context of the territories.

[3] Government of Canada, Mr. Justice Thomas R. Berger. (1977). *Northern Frontier, Northern Homeland, The Report of the Mackenzie Valley Pipeline Inquiry: Volume One*, p. vii.

Although many of these issues extend beyond the mandate of the Panel, we cannot conclude our work without urging the territories, the federal government, and Aboriginal and Inuit people to:

- Reach agreements on devolution and resource-revenue sharing
- Address significant challenges in the territories ranging from housing and infrastructure, to health care, education, and social issues
- Take urgent action to address serious problems in Nunavut
- Continue to seek innovative, effective, and affordable solutions for providing public services and meeting the needs of people in the territories

The Panel members sincerely hope that our recommendations will help enable the territories and northerners to achieve their "great promise."

As the framework for the joint federal-territorial Northern Strategy indicates, "The North is a place of great promise. For many years northerners have spoken about the importance for all Canadians to share in a vision for the future that enables northerners to become full participants in the federation."[4]

As Panel members, we sincerely hope that our recommendations will help enable the territories and northerners to achieve their "great promise."

[4] Government of Canada (2004). *Nation-Building, Framework for a Northern Strategy*, p. 1.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

LAUNCHING A COMPREHENSIVE REVIEW

Starting with fundamental principles

Canadians have long been committed to the principle of sharing and the idea that, as part of a vast and diverse federation, Canadians, no matter where they live, should have access to reasonably comparable public services at reasonably comparable levels of taxation.

In a practical sense, it means that if people live in Newfoundland or Nunavut or Yellowknife or Yorkton, their children should have reasonably comparable opportunities to get a good education. They should have access to reasonably comparable health care services, social services, and justice systems. And the taxes they pay to support those services should be reasonably comparable across the country.

This important principle is enshrined in the Canadian Constitution and it provides the basis for the federal Equalization program. Although the territories are not specifically mentioned in this section of the Constitution, this principle applies to the territories as well through the federal government's commitment to Territorial Formula Financing (TFF).

Under the Equalization and TFF programs, the federal government receives taxes from all Canadians and uses a portion of those taxes to provide financial support to provinces and territories that, for a variety of reasons, are less wealthy and less able to provide comparable public services without charging unacceptably high levels of taxes.

It sounds straightforward in theory and in principle. But that's where the simplicity ends. As many commentators and academics have noted, the saying 'the devil is in the details' certainly rings true for both Equalization and TFF.

Furthermore, in spite of the fact that the programs involve billions of dollars in funding every year (about $11 billion for Equalization and just over $2 billion for TFF in 2006–07), until recently the programs have received very little public attention. It's fair to say that the programs have been largely ignored and little understood by the vast majority of Canadians.

As a result, there are numerous misconceptions about how the programs work, what they are designed to achieve, and what should be done to improve these programs for the future.

Expert Panel established

In March 2005, the federal Minister of Finance announced the beginning of a comprehensive review of both Canada's Equalization program and Territorial Formula Financing. The review was launched as an outcome of the First Ministers' Meeting on Equalization and Territorial Formula Financing in October 2004.[5]

In relation to TFF, the Panel was specifically asked to provide advice to the Government of Canada on:

- The allocation of TFF among the three territories
- Ways of making the payments to the territories more stable and predictable
- Ways of measuring the costs of providing services in the territories to assist in future re-evaluations of the overall level of federal support for TFF
- Whether a permanent, independent body should be created to provide ongoing advice to the Government of Canada on the allocation of TFF
- How to address difficult or challenging issues that could be involved in implementing the approach recommended by the Panel

Territorial Formula Financing is distinctly different

Although the fundamental objective underlying both Equalization and TFF is the same, the programs are vastly different in terms of how they are designed, what they measure and how they operate.

Both programs provide unconditional transfers from the federal government to receiving provinces and to each of the three territories. That means there are no strings attached. The federal government does not require the provinces or territories to spend the money on particular programs or services. The provincial and territorial governments make decisions and are accountable to their citizens for how the money is spent.

[5] For more information, see the Expert Panel's website at http://www.eqtff-pfft.ca, which features its Discussion Paper outlining key issues for Equalization and TFF.

Both programs respond to changes in population; more money is provided to less-wealthy provinces and territories if their populations go up and less money is provided if their populations go down. Both programs use a variety of similar methods to calculate the revenue capacity of provinces and territories and their tax effort; however, TFF includes some features that recognize the more limited ability of the territories to raise revenues.

On the other hand, the differences are significant. Equalization does not explicitly take the different expenditure requirements of provinces into account in determining their eligibility for Equalization funding or how much money they receive. TFF explicitly includes a proxy measure of expenditure need. The TFF formula was designed to fill the gap between expenditure needs (how much money a territory needs to cover the costs of providing reasonably comparable public services to its citizens) and revenue capacity (how much money a territory can potentially raise from a combination of taxes, fees, and some other federal transfers).

The TFF formula was designed to fill the gap between expenditure needs (how much money a territory needs to cover the costs of providing reasonably comparable public services to its citizens) and revenue capacity (how much money a territory can potentially raise from a combination of taxes, fees, and some other federal transfers).

TFF also is much more critical to the territories than Equalization is to the provinces since it makes up between 64 and 81 percent of their total budgetary revenues. TFF is critical to future development in the territories and its peoples. The combination of high costs of providing public services and strong economic potential, coupled with the stark reality of serious challenges in housing, health, and education, underscores the need for a separate and deliberate treatment of TFF. Those factors also highlight the need to address the unique and very different perspectives of each of the territories and the purpose of TFF in helping the territories achieve their aspirations for the future.

For those reasons, the Panel has chosen to treat Equalization and TFF separately.

Consultations on Territorial Formula Financing

From the outset, the Panel made a commitment to actively engage a wide variety of people and organizations in the review process. One member of the Panel, Dr. Michael Percy, was explicitly charged with responsibility for taking the lead on identifying and addressing territorial issues.

As part of the consultations, the Panel:

- Held initial consultations with representatives of the three territorial governments in April 2005

By painting a picture of the uniqueness of the territories, our hope is that readers of this report will gain not only a better appreciation of the North today but also will understand the context for the Panel's recommendations on restructuring the TFF program.

- Held a roundtable discussion with 47 participants in Yellowknife on August 25, 2005
- Met with the Premier and Minister of Finance of Yukon and Ministers of Finance from the Northwest Territories and Nunavut
- Met with officials from the Government of Nunavut in Iqaluit to get a clearer understanding of their unique needs and challenges
- Met with officials from the federal Department of Finance
- Gathered extensive information from the territories through their joint submission, follow-up discussions, and review of detailed information and analyses
- Reviewed submissions from academics, other groups, and interested individuals

A list of participants in the consultation process is included in Annex 1.

Throughout this extensive process, members of the Panel learned about TFF, about its importance to the territories and the strengths and weaknesses of the current approach. But perhaps just as important, the Panel gained a deeper understanding of the unique challenges of the North, the territories' aspirations to achieve self-reliance and financial self-sufficiency, the complexity of the issues involved, and their strong desire to create a better future for all people in the territories.

So that's where this report begins. By painting a picture of the uniqueness of the territories, our hope is that readers of this report will gain not only a better appreciation of the North today but also will understand the context for the Panel's recommendations on restructuring the TFF program.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

UNIQUE CHALLENGES IN THE TERRITORIES

Assessing how TFF works today and deciding what changes should be made to improve the program for the future cannot and should not be done in isolation of the larger context of the unique challenges of the territories.

Because TFF plays such an important role in supporting essential programs and services in the territories, the stakes are high. Changes to the current program can have a dramatic effect on the ability of the territories to promote economic development, secure much-needed investment, and provide basic education, health, and other services to a growing population. Combined with that, a number of major economic developments are currently in progress, anticipated, or are being planned. Responsibilities for resource developments have been devolved to Yukon and to First Nations and Aboriginal governments. In the Northwest Territories and Nunavut discussions are still underway.

Because TFF plays such an important role in supporting essential programs and services in the territories, the stakes are high.

The combination of these challenges is unique in Canada. How they are addressed will have a profound effect on the future of the territories.

Further information on the unique needs in the territories is included in Annex 2.

"The variance within the North is as great as the variance across all jurisdictions and these different circumstances create different costs for providing government programs and services, and also dramatically different fiscal capacities."

- Joint Territorial Submission to the Expert Panel[6]

Identifying needs and challenges

The situation in the three territories is vastly different from southern Canada, and there are significant differences even among the three territories. For people living in downtown Toronto, Vancouver, Montréal or Calgary, it's difficult to imagine a vast expanse of land roughly half the size of Canada and inhabited by just over 100,000 people, many of them located in small, remote communities accessible only by air, water, or ice roads in the winter.

While most provinces face challenges in delivering public services to people in smaller communities, those challenges pale in comparison with those in the territories. The following facts and trends provide a snapshot of life in Canada's North and underscore why costs for providing public services are so much higher than in the rest of Canada.

While most provinces face challenges in delivering public services to people in smaller communities, those challenges pale in comparison with those in the territories.

[6] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 9.

"The North is a frontier, but it is a homeland too, the homeland of the Dene, Inuit and Métis, as it is also the home of the white people who live there. And it is a heritage, a unique environment that we are called upon to preserve for all Canadians."

- Mr. Justice Thomas R. Berger[7]

Population growth outpaces the rest of Canada

The population in the three territories is small in comparison with the rest of Canada. The latest information for 2004 shows a combined population of just under 104,000 people. In Nunavut, 85 percent of the population is Inuit compared with 50 percent Aboriginal people in the Northwest Territories and 20 percent in Yukon. Across Canada, Aboriginal people comprise only about three percent of the population.[8]

Looking ahead, the population of all three territories is expected to grow at a higher rate than the rest of Canada. By far, the largest increase will occur in Nunavut, where the population is expected to grow by 26 percent from 2004 to 2019.[9]

Geographic dispersion and isolation drive costs

Because people in the territories are spread out over vast distances, frequently in small remote communities with few, if any, transportation links, the territories face unique challenges in providing education, health, social services, and infrastructure to their residents. Economies of scale are virtually impossible. Unlike communities in southern Canada, where children can be bussed to school or people can drive to the nearest hospital, those options simply are not possible in most parts of the territories.

Not surprisingly, these factors drive costs substantially higher for delivering public services in the territories.

Health care costs are high and outcomes are poor

All provinces face challenges in containing increasing costs and demand for health care. But in the territories, it's doubly challenging because of much higher needs, shortages of health care providers, lack of full-service medical care, and medical transportation costs.

All provinces face challenges in containing increasing costs and demand for health care. But in the territories, it's doubly challenging because of much higher needs, shortages of health care providers, lack of full-service medical care, and medical transportation costs. On top of that, health status, especially in Nunavut, is much worse than anywhere else in Canada.

In spite of significantly higher spending in the territories compared with the rest of Canada, indicators of health status in the territories show lower life expectancies, higher infant mortality rates, significantly more years of life lost due to unintentional injuries, higher rates of death from lung cancer, and fewer people who rate their own health as good or excellent.[10]

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7 Government of Canada. Mr. Justice Thomas R. Berger. (1977). *Northern Frontier, Northern Homeland, The Report of the Mackenzie Valley Pipeline Inquiry: Volume One*, 1977, p. vii.

8 Government of Canada. Statistics Canada (2001). *Census of Canada, 2001.*

9 Government of Canada. Statistics Canada, Government of the Northwest Territories, Bureau of Statistics. Government of Yukon, Bureau of Statistics.

10 Government of Northwest Territories. (2005). *Comparable Health Indicators, 2005*; Government of Nunavut.(2005). *Comparable Health Indicators, 2004*; Government of Yukon. (2005). *Comparable Health Indicators, 2004.*

The situation in Nunavut is particularly disturbing. Compared with the rest of Canada:

- Life expectancy is 10 percent lower
- The rate of infant mortality is three times higher
- Thirty-eight percent more infants are born with a low birth weight
- Tuberculosis rates are 18 times higher
- Suicide rates are 10 times higher
- Smoking rates are three times higher for youth and twice as high for adults[11]

Social indicators point to serious challenges

Compared with the rest of Canada, the territories have higher rates of single-parent families, higher average unemployment rates (except for the Northwest Territories), substantially higher suicide rates, and higher rates of violence and property crimes. Again, the situation in Nunavut is much more serious than in the other two territories.

Education indicators are improving

High school graduation rates are improving in all three territories, including rates for Aboriginal and Inuit students. In the Northwest Territories and Yukon, the rates are comparable with the rest of Canada, but high school graduation rates in Nunavut are the lowest in Canada. About one of out every three students doesn't finish high school in Nunavut.

At the Panel's Roundtable in Yellowknife, deficiencies in education and training were seen as a major obstacle to social and economic development and a particularly difficult barrier for Aboriginal and Inuit people.

"The expenditure needs gap is not just a measure in accounting legers. It is also measured in inadequate housing, poor health, low education and inadequate infrastructure."

- Nunavut Association of Municipalities/ Nunavunmi Nunaliit Katojikatigiigit[12]

Infrastructure and housing are serious problems

All three territories face particular challenges in providing adequate and affordable housing. A significant proportion of the current supply of housing is in need of repairs and the costs of construction, maintenance, serviced land, shipping, and labour are substantially higher than in southern Canada. The situation in Nunavut is particularly serious. More than half of the peo-

[11] Information provided by the Government of Nunavut, Department of Health and Social Services, October 2005.

[12] Nunavut Association of Municipalities/Nunavunmi Nunaliit Katojikatigiigit. (2005). Submission to the Expert Panel on Equalization and Territorial Formula Financing, p. 2.

The situation in Nunavut is particularly serious. More than half of the people in Nunavut live in public housing and the current supply is not adequate to meet expected population growth. The result is overcrowding, with much higher than average numbers of people living in the same home. This contributes directly to significant social, education, and health problems.

ple in Nunavut live in public housing and the current supply is not adequate to meet expected population growth. The result is overcrowding, with much higher than average numbers of people living in the same home. This contributes directly to significant social, education, and health problems.

In addition to the need for housing, the existing infrastructure of roads, airports, water, sewer, and waste disposal is aging. Costs for repairs and replacements are substantial. While provinces face similar challenges with replacing an aging infrastructure, the challenge for the territories is compounded by higher costs and less fiscal capacity to raise the necessary funds.

Revenues and natural resources are critical issues

As noted earlier, all three territories are heavily dependent on TFF and other federal transfers to support essential public services and investments in infrastructure.

While all three territories are striving to increase economic activity and expand their own sources of revenues, primarily through income taxes, the reality is that even substantial economic developments don't necessarily result in significantly higher revenues for the territories under the current arrangements. In many cases, businesses involved in developments in the territories are based outside the territories and pay their taxes in other jurisdictions. The same is true for a transitory workforce that comes to the territories for jobs, but lives permanently and pays taxes in southern Canada.

One of the most promising opportunities for the territories is the potential for and continued development of their rich natural resources, particularly oil, gas and diamonds.

One of the most promising opportunities for the territories is the potential for and continued development of their rich natural resources, particularly oil, gas and diamonds. Constitutionally, however, the authority for natural resource development and management in the three territories lies with the federal government. This includes the right to set, administer, and collect royalties from resources. Under existing arrangements, the federal government benefits significantly from resource development in the territories, much more than the territorial governments and other interests.

Since the 1980s, the Government of Canada has been pursuing a policy of devolution in which the authority for setting, administering, and collecting resource revenues and managing resource development would be transferred to the territories through agreements and legislation. In September 1988, an agreement in principle was reached with Yukon and the Northwest Territories setting out the parameters for transferring authority for oil and gas. Under this agreement, oil and gas revenues (except those under Aboriginal Land Claims) were to be for the use and benefit of territorial governments. The territories would receive a net fiscal benefit in order to

provide an incentive to increase resource development. If the revenues reached a particularly high level, the federal government would retain an increasing proportion of the incremental revenues.

Since then, only the Government of Yukon and some Yukon First Nations have reached agreements with the federal government on devolution and resource revenue sharing. Discussions are ongoing with the Government of the Northwest Territories and the Aboriginal Summit. Talks with the Government of Nunavut are in the preliminary stages.

"In the past, Canadian efforts to share national prosperity and ease regional poverty have been almost exclusively in the south. Now, the North will have to become an integral part of the Canadian economic community. It will join as an under-privileged member for, despite changes and progress, the social problems of the North are still acute and the cost of resolving them will be great."

- David Judd
Quoted in William C. Wonders, Canada's Changing North[13]

Devolution and resource revenue sharing is underway

As noted earlier, a large percentage of the population of the territories is made up of Aboriginal and Inuit people. Across the three territories, there are different fiscal arrangements and self-government agreements in place among the federal government, the territorial governments, Inuit organizations, First Nations, and Aboriginal organizations. The majority of the financial arrangements include sharing revenues (including resource revenues) among the First Nations, Aboriginal governments and organizations, and the territorial and federal governments. These arrangements can also have an impact on TFF and certainly on the overall level of federal transfers to territorial governments.

IN SUMMARY

- Costs are substantially higher in the territories primarily because of geographic dispersion, isolation, and costly transportation.
- All three territories rely heavily on TFF and other federal transfers to pay for essential public services.
- A number of indicators point to serious social problems combined with inadequate housing, lower health and education outcomes, and an urgent need to replace and expand existing infrastructure.
- Although there are problems in all three territories, the situation in Nunavut is particularly serious and troubling.
- Issues related to devolution and resource revenue sharing with the territorial governments, Aboriginal governments and organizations, and Inuit organizations are complex and will take time to resolve.
- While there is great potential for economic development from natural resources in the territories, investment is needed, and the overall benefits to the three territories will not be realized in the short term.
- Their determination to become self-reliant is an important priority for the territories and for Canada. Changes to TFF should contribute to this goal. However, for the foreseeable future, TFF will continue to be a significant source of funding for all three territories.

[13] William C. Wonders. (1971). *Canada's Changing North*, 1971, p. 347.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

UNDERSTANDING TERRITORIAL FORMULA FINANCING

"When one works intimately with TFF and related territorial fiscal matters in-depth, one tends to become very humble because of the complexities involved. One learns several things. First and foremost, 'the devil is in the details.'

R. C. Zuker and T.R. Robinson[14]

Make no mistake: Territorial Formula Financing (TFF) is not a simple program. The underlying principles and objectives of the program are straightforward, but the formulas, and particularly how they have evolved over time, add layers of complexity that are beyond the understanding of all but a few who work with the program on an ongoing basis. Complex formulas do not promote either transparency or accountability to Canadians.

Make no mistake: Territorial Formula Financing (TFF) is not a simple program.

At the same time, given the importance of the program to the territories and the amount of money involved, it's important to understand the basic elements of the program and how it works. A more detailed description of the history of TFF and how it works is provided in Annex 3.

The basics of Territorial Formula Financing

The TFF program has been in place since 1985–86 and it is the main federal transfer to the territories. Its objective is to provide territorial governments with sufficient revenue to allow them to offer reasonably comparable levels of public services to northern Canadians (at reasonably comparable levels of taxation) as those that are available to all other Canadians, taking into account the unique circumstances in the territories.

Complex formulas do not promote either transparency or accountability to Canadians.

[14] Zuker R.C. and T.R. Robinson. *Fixing Territorial Formula Financing*. (2005). Submission to the Expert Panel on Equalization and Territorial Formula Financing, p. 6.

TABLE 1 – Territorial Formula Financing (TFF) Entitlements, 1993–94 to 2006–07

		$ millions		
Year	Yukon	Northwest Territories	Nunavut	Total
1993–94	289	861	0	**1,150**
1994–95	289	892	0	**1,181**
1995–96	291	906	0	**1,197**
1996–97	289	908	0	**1,197**
1997–98	307	921	0	**1,229**
1998–99	310	935	0	**1,246**
1999–00	319	493	520	**1,333**
2000–01	336	310	566	**1,212**
2001–02	359	546	613	**1,518**
2002–03	372	588	656	**1,616**
2003–04	435	626	692	**1,754**
2004–05	466	678	756	**1,900**
2005–06	487	714	799	**2,000**
2006–07*	506	738	827	**2,070**

** As announced by the federal Minister of Finance in November 2005*
Source: Department of Finance Canada

Starting with a formula-driven approach

Prior to 2004–05, TFF was determined and allocated on the basis of a formula. The formula was established in 1985 and it was designed to provide territorial governments with annual, unconditional grants. Each territorial government could allocate and spend TFF grants according to its own priorities. The TFF formula was reflected in Territorial Formula Financing Agreements between the federal government and each of the territories.

The formula worked like this:

TFF grant = Gross Expenditure Base minus Eligible Revenues

The formula was designed to fill the gap between the costs of providing public services in the territories and their ability to pay for those services with their own sources of revenue. The TFF grant each territory received was based on a proxy measure of how much money it needed to provide public services (its Gross Expenditure Base) minus a measure of how much

money it had from its own sources of revenue and some other federal transfers (its Eligible Revenues). A TFF grant was determined separately for each territory.

Now for some of the technical terms and details.

Measuring expenditure needs

The Gross Expenditure Base (GEB) is a proxy measure of each territory's expenditure needs. It was based on the amount of territorial revenues in the Northwest Territories and Yukon in 1982–83, with some adjustments. It is not a measure of how much each territory actually spends on public services, but rather an approximation of what each territory would need to provide reasonably comparable public services. At the time the TFF program was established, it was considered adequate to reflect variations in both needs and the costs of providing public services in the territories.[15]

The GEB is adjusted every year by an escalator

It was assumed that, because territories have similar responsibilities as provincial and local governments in the rest of Canada, their expenditure needs would increase at roughly the same rate. Starting in 1990, changes in a territory's population were also taken into account. The escalator used in the TFF formula to annually adjust for changes in expenditure needs (GEB) was called the Population-Adjusted Gross Expenditure Escalator (PAGE).

Other adjustments have been made to the GEB

A number of adjustments have been made to the GEBs for the territories since the program was introduced. As program responsibilities were transferred from the federal government to the territories (e.g., airports, implementing the Young Offenders Act), the federal government provided additional ongoing funding required in order to operate the programs. This amount was added to each territory's GEB. Two important changes also took place in the federal government's 1995 budget as part of its plans for eliminating its deficit. The grants to the territories for 1995–96 were frozen at their 1994–95 level and the 1996–97 GEBs were reduced by five percent. Also, when Nunavut was established in 1999, additional funding was added to the former Northwest Territories' GEB, and then that GEB was divided between the new Nunavut Territory and the Northwest Territories.

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[15] Government of the Northwest Territories, Government of Nunavut, Government of Yukon (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, pp. 2-3.

Measuring revenue capacity

Under the TFF formula, Eligible Revenues were included as a measure of a territory's fiscal capacity and reflected each territory's ability to raise its own revenues.

Revenues that territories control are included in Eligible Revenues

The measure of each territory's Eligible Revenues included all tax revenues from income taxes, tobacco, fuel, and property taxes, all fees and licenses, and some other smaller sources of revenue. This measure was then adjusted to take into account a number of factors such as the tax effort (adjusted for the high cost of living) of each of the territories in comparison with average tax rates in the provinces. Other federal transfers to the territories were partially included or excluded in the calculation of Eligible Revenues.

Some sources of revenues were not included in the previous TFF formula, including:

- Natural resource revenues (addressed through separate revenue-sharing agreements currently in place with Yukon)
- Some funding provided by the federal government for health care and social programs
- Some interest revenues
- Any new recoveries or transfer payment programs introduced after March 31, 1985

An Economic Development Incentive is included

The basic concept in the TFF formula was that, as territories developed more capacity to raise money themselves, the amount of money they received from the TFF grant would decrease. To address concerns that the interaction between a territory's measured tax effort and new revenue growth could act as a disincentive to promoting economic development and raising new revenues in the territories, an Economic Development Incentive (EDI) was introduced in 1995–96. This adjustment allowed territories to exclude 20 percent of the incremental growth in their tax bases from the calculation of their entitlement under TFF. In effect, it allowed territories to keep more of the additional revenues they gained from economic growth without having those gains more than offset by reductions in TFF.

The New Framework

In October 2004, the federal government replaced the previous TFF formula with a New Framework that applied to both TFF and Equalization. Key features of the New Framework for TFF are:

- The TFF formula was set aside and a fixed envelope of funding was established.
- Unlike the previous TFF arrangements, the New Framework is established in legislation and grants to individual territories are based on federal legislation (*Federal-Provincial Fiscal Arrangements Act*), not on separate agreements between the federal government and each territory.
- The total amount of funding to be provided through TFF for all territories was increased and set at $1.9 billion for 2004–05, $2 billion for 2005–06, and $2.07 billion for 2006–07.
- The total funding will grow by 3.5 percent a year, with a review scheduled for 2009–10.
- Rather than calculating the grants to each of the territories separately, the three territories receive shares of the overall pool of TFF funds based on an average of the relative shares they received in the previous three years.

The New Framework is a significant conceptual change for the territories, much more significant than for the provinces.

The New Framework is a significant conceptual change for the territories, much more significant than for the provinces. In addition to legislating TFF, the New Framework also means that TFF is no longer based on three separate gap-filling formulas.

The New Framework provides guaranteed and predictable overall funding increases, thereby improving the stability of TFF. It also provides fiscal benefits to the territories. The total amount of TFF funding is set in legislation and will not be reduced, even if the territories' own sources of revenues increase. This amounts to a 100 percent economic development incentive, because the total amount of money available for TFF will not decrease, even if the territories' own-source revenues increase.

The New Framework fundamentally changes the dynamics among the three territories because the amount they gain or lose in a fixed pool of funding depends not only on their own situation, but on changes in revenues and population in the other two territories.

On the other hand, the New Framework's fixed escalator of 3.5 percent does not reflect the actual changes in expenditure needs in the territories as a result of population changes or growth in expenditures. It also means that the three territories share both the upside and the downside risks of changes in their own-source revenues. While the total amount of TFF funding is fixed, the shares each territory receives can vary on a year-to-year basis. For example, if revenues increased in the Northwest Territories, its grant would decline while the TFF grant to the other two territories would rise.

For this reason, the New Framework fundamentally changes the dynamics among the three territories because the amount they gain or lose in a fixed pool of funding depends not only on their own situation, but on changes in revenues and population in the other two territories.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

ISSUES AND IDEAS

Through its various consultations, meetings, and discussions, the Panel learned about a number of issues related to the previous TFF formula and the New Framework, as well as ideas and options for how the program might be restructured and improved.

This section provides highlights of the key issues and ideas raised during consultations about TFF. Copies of the various submissions specific to TFF are included on the Panel's website.[16]

Adequacy of Territorial Formula Financing in meeting needs in the territories

In 2005–06, the TFF grant made up between 64 and 81 percent of territorial budgetary revenues. Not surprisingly, the adequacy of TFF funding was a dominant theme and overlapped with discussions about the unique challenges in the territories.

The Joint Submission from the three territories argued that when TFF was first introduced, the funding it provided to the territories was adequate.[17] The three territories also supported the annual escalator for the GEB, (PAGE) which was based on relative growth in population in the territories and growth in spending by provincial and local governments. However, the submission indicated that subsequent changes to the TFF formula have led to inadequate funding, including introduction of a ceiling on TFF funding, a five percent reduction in territorial GEBs introduced in 1996–97, and the introduction of the Tax Effort Adjustment Factor (TEAF) in 1990–91.

The Submission indicates that, although the New Framework implemented in 2004 provides additional funding, it does not restore TFF to the level required to meet its original objectives. At the same time, it's important to note that the territories have received significant new investments in recent years through both TFF and other federal funding initiatives. The New Framework provided an additional $100 million in 2004–05 and an additional $100 million in 2005–06, and provided for an annual 3.5 percent increase in overall TFF grants. Other federal investments include increases in funding for health and social transfers ($44 million), a new Northern Strategy ($120 million), the New Deal for Cities ($37.5 million), infrastructure funding ($211 million), and the Territorial Health Access Fund ($150 million). This does not take into account a number of other investments in northern economic development, health, northern oil and gas development, and environment.[18]

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[16] The Panel's website is http://www.eqtff-pfft.ca.

[17] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Submission to the Expert Panel on Equalization and Territorial Formula Financing*, pp. 2-3.

[18] Information provided by Finance Canada.

In November 2005, the meeting of First Ministers and Aboriginal Leaders resulted in a commitment of $5 billion in funding over the next five years, some of which would be allocated in the three territories to address education, housing, health, and infrastructure needs.[19]

Other submissions and discussions underscored the unique needs and challenges of the territories. As noted in an earlier section, despite the enormous potential of the territories, "there are many barriers to realizing that potential as well as ensuring that northerners, especially Aboriginal people, have the capacity to fully participate in it."[20]

It's hard not to be struck by a sense that the territories are on the brink of major change, particularly in the Northwest Territories.

There is little doubt that costs are significantly higher in the territories, demands for certain public services are also higher, and outcomes in health and education are poorer. As well, the combination of devolution and resource revenue sharing agreements, Land Claims and Aboriginal self-government agreements add a layer of complexity to fiscal arrangements not seen in southern Canada.

Throughout the consultations and in submissions to the Panel, proposals were made about how to adequately measure expenditure needs, simplify the measurement of revenue capacity, and improve incentives for economic development.

There's a desire for self-sufficiency and independence. But, at the same time, there's recognition that the barriers to self-sufficiency are substantial.

Self-sufficiency and economic development in the territories

Reading through the various submissions and listening to people in the territories, it's hard not to be struck by a sense that the territories are on the brink of major change, particularly in the Northwest Territories. There's a strong desire to take advantage of the huge potential for economic growth based on natural resource development. There's a strong hope that these economic developments will result in long-term benefits for all northerners, particularly if they result in a better capacity to improve outcomes in health, education, housing, and a number of other social issues. There's a desire for self-sufficiency and independence. But, at the same time, there's recognition that the barriers to self-sufficiency are substantial. In the territories' view,

"A key objective of all three territories is to reduce their dependence on federal transfers. All three territories agree that there must be incentives within TFF to make the investments necessary to encourage economic development and subsequently increase own source revenues."

- Joint Territorial Submission to the Expert Panel[21]

[19] Government of Canada.(2005) First Ministers and National Aboriginal Leaders. *Strengthening Relationships and Closing the Gap* and News Release.

[20] J. Feehan.(2005). *Summary Report: The Expert Panel Roundtable held at Yellowknife, Northwest Territories*, August 25, 2005. www.eqtff-pfft.ca/english/documents/FinalReport-Yellowknife.pdf.

[21] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 9.

the cost of providing essential public services will continue to be beyond their fiscal capacity until and unless major economic developments materialize. There also are significant challenges in human and capital infrastructure.

It is important to recognize that the TFF grant is not designed to resolve all of these issues. However, TFF should contribute to the territories' goal of self-sufficiency and should not provide disincentives for economic development.

The territories (and the provinces, in the case of Equalization) argue that the way the TFF operates can act as a disincentive for promoting further economic growth. When there's a new mine or new exploration activity, the territorial government benefits from a combination of more corporate taxes and more personal income taxes because more people are working. Under the previous TFF formula, the TFF grant would be reduced as a territory's own revenues increased. This reduction in federal funding is typically referred to as a "claw-back."

Depending on the specifics of the TFF formula, the TFF grant could be reduced by about 80 percent of the additional revenues raised by the territories. Although the territories offer no evidence in their Joint Submission to the Panel, in their opinion the additional revenue generated by economic development is not sufficient to offset the additional costs they incur in providing public services and supporting resource developments. On the other hand, few would argue that there aren't significant overall benefits to northerners from economic developments that bring employment and future opportunities for young people.

The territorial governments and other participants at the Yellowknife Roundtable suggested that the territories should be able to retain a greater share of their own-source revenues, including those from natural resource developments, without seeing a corresponding reduction in TFF funding. A number of participants also made the point that Aboriginal people should get their fair share of revenues from resource development, without reducing other financial transfer arrangements. Additional revenues from resource developments would provide territorial governments and Aboriginal people with a greater capacity to address the social and infrastructure costs associated with economic development. Even the Economic Development Incentive (EDI) in the previous TFF formula is not considered

A number of participants also made the point that Aboriginal people should get their fair share of revenues from resource development, without reducing other financial transfer arrangements.

Additional revenues from resource developments would provide territorial governments and Aboriginal people with a greater capacity to address the social and infrastructure costs associated with economic development.

"The territories need to retain additional revenues generated from their investments in order to make such investments worthwhile. The capital investments needed to create the environment for economic development are substantial and beyond the territories' current fiscal capacities. While these investments would generate economic activity and therefore more revenues for a territory, they also create other social and economic pressures that strain each territory's financial resources."

- Joint Territorial Submission to the Expert Panel[22]

[22] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 18.

The 3.5 percent escalator was not sufficient to address the rising cost of providing public services in the territories, particularly since it is not responsive to changes in population.

by the territorial governments as adequate to support additional demands on public programs and services resulting from economic development, particularly since the impact of the EDI varies greatly among the three territories.

Concerns with the New Framework

A number of concerns were raised with the New Framework for TFF.

The Joint Territorial Submission outlined four key concerns:

- The initial fixed amounts provided in the New Framework do not restore the adequacy of TFF funding and the allocations for 2005–06 do not reflect the full program responsibilities of the territorial governments.
- The annual 3.5 percent increase in total funding is inadequate compared with the previous TFF formula.
- The growth in per capita funding for the territories under TFF will be less than for the provinces under Equalization. The 3.5 percent escalator is applied to the total amount of funding available for both TFF and Equalization. In the case of the provinces, this may be sufficient to accommodate their population growth, but in the case of the territories it doesn't reflect their relatively higher rates of population growth.
- Setting a fixed envelope for TFF creates a "zero-sum game" for territories. Gains in one territory will come at the expense of the other territory or territories.

"In short, Ottawa is once again imposing a solution on the North that has the single virtue of maintaining predictability for the federal government alone, and is bound to foster exactly the same deficiencies experienced under the previous agreement, i.e. a failure to adequately equate funding levels with actual need."

- NWT Chamber of Commerce and NWT Construction Association[23]

Other submissions to the Panel and discussions during the Yellowknife Roundtable echoed concerns with the New Framework, particularly the impact on changing the dynamics among territories and pitting territories against each other. Others suggested that the 3.5 percent escalator was not sufficient to address the rising cost of providing public services in the territories, particularly since it is not responsive to changes in population. It was also suggested that, while the New Framework was described as a way of providing greater stability and predictability, in fact, it provides more predictability only for the federal government. An individual territory's share of the total pool of TFF funds could change substantially on a year-to-year basis, even though its economic and fiscal situation may not have changed. The Joint Territorial Submission indicated that the territories are less concerned with stability than they are with the adequacy and responsiveness of TFF.

"... in a three-player game where the stakes are 70 to 90 percent of total revenues and in the absence of the flexibility of own-source revenues (as the provinces have) marginal gains are significant and competitive behaviour necessary."

- Joint Territorial Submission to the Expert Panel[24]

[23] NWT Chamber of Commerce and NWT Construction Association. (2005). *Joint Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 2.

[24] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 26.

Simplicity and transparency

The need to simplify TFF, make the program easier to understand, and reduce the administrative burden on governments was highlighted in a number of submissions and comments. Concerns were raised that the "overall design of Territorial Formula Financing has become exceedingly complex with successive agreements and adjustments over the past 20 years."[25] This complexity has come at the expense of transparency, so that few people actually understand how TFF works.

TFF complexity has come at the expense of transparency, so that few people actually understand how the program works.

On the other hand, the Panel was cautioned against believing that simplicity in itself should be an over-riding objective for TFF. The comparison was drawn to the tax system where "we want everyone to have a basic understanding of our tax system, but who would argue that the tax laws, regulations and rulings should only be two pages long, so that everyone can understand the internal workings."[26] In the case of TFF we could argue that there's a long way to go before "everyone has a basic understanding" of how the program works.

Devolution and resource revenue sharing

Many submissions and discussions highlighted the importance of Aboriginal self-government and Land Claims agreements in the future development of the territories. In particular, current discussions and developments regarding potential devolution and resource revenue sharing agreements and Aboriginal self-government in the Northwest Territories were highlighted. These changes in governance and responsibilities, as well as the potential for additional fiscal resources, mean that TFF has to be flexible enough to accommodate different governance arrangements in the three territories. Furthermore, there is an explicit understanding that the result of new agreements and changes to TFF must be a shared benefit among all who live in the territories, particularly Aboriginal and Inuit people.

There is an explicit understanding that the result of new agreements and changes to TFF must be a shared benefit among all who live in the territories, particularly Aboriginal and Inuit people.

At the Yellowknife Roundtable, concerns were also expressed about the potential for a "double claw-back" of revenues in Yukon and the Northwest Territories. In the view of a number of stakeholders, this occurs due to a potential interaction between devolution and resource revenue sharing agreements with the TFF and financial transfer arrangements for Aboriginal governments.

[25] Slack, E.. (2005),*Territorial Formula Financing*. Submission to the Expert Panel on Equalization and Territorial Formula Financing, p. 13.

[26] Zuker R. and T.R. Robinson. (2005). *Fixing Territorial Formula Financing*. Submission to the Expert Panel on Equalization and Territorial Formula Financing, p. 7.

Options for new approaches

A number of submissions suggested alternative approaches for addressing key concerns about the New Framework for TFF.

The Joint Territorial Submission recommended that:

- Separate, stand-alone arrangements should be in place for each territory because of their significant differences in economic and political development.
- The escalation of TFF should not be arbitrary but based on a formula.
- The new TFF should adhere to established principles, although the trade-offs between different principles may vary depending on how the formula is designed.
- A new TFF should address concerns with the adequacy of funding while recognizing the very different circumstances of each territory.

The Joint Territorial Submission also suggested that the Panel consider two options: either introduce a simplified approach to the previous TFF formula (using five of the largest territorial tax bases and an increase in the economic development incentive), or replace the formula with a block grant that would be adjusted based on a combination of population growth and growth in provincial and local expenditures (as in the previous TFF formula).[27]

Other submissions suggested different approaches for measuring both expenditure need and revenue capacity of the territories. One submission provided options for doing an extensive study on expenditure needs in order to establish updated measures of the territorial GEBs for TFF. None of the submissions considered a macro approach to measuring expenditure need or revenue capacity as appropriate in the territories.[28]

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[27] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. iii.
[28] Op.Cit., pp. 29-30 and pp. 62-63.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

A NEW APPROACH TO TERRITORIAL FORMULA FINANCING

The Panel carefully considered all the advice and ideas it received on how to improve TFF. And it considered these ideas and options in the context of the opportunities and challenges of the territories, the principles underlying TFF, and the importance of TFF to the capacity of the three territories to respond to their own unique needs.

The following section outlines the Panel's recommendations for a new approach to TFF. It retains many of the key features of the previous TFF formula, but it simplifies the measurement of revenue capacity and provides the flexibility necessary to accommodate future Aboriginal self-government, Land Claims agreements, and devolution and resource revenue sharing arrangements.

It is designed to provide a solid base for the future, funding bases that the territories can rely on to meet their current and anticipated demands.

Perhaps most important, it is designed to provide a solid base for the future, funding bases that the territories can rely on to meet their current and anticipated demands. These new bases should allow the territories to address pressing needs, prepare for anticipated developments, move towards self-reliance and self-sufficiency, and achieve better outcomes for all people across Canada's territories.

A detailed explanation of the Panel's new approach is provided in Annex 4.

Starting with principles

In its review of both Equalization and TFF, there's one message the Panel has consistently heard: the need to get back to fundamental principles.

Leading up to the renewal of TFF in 2004, the territories and the federal government worked on a set of eight principles, that were never finalized.

The Panel recommends that these principles be adopted as the fundamental principles for TFF.

These solid bases for the future should allow the territories to address pressing needs, prepare for anticipated developments, move towards self-reliance and self-sufficiency, and achieve better outcomes for all people across Canada's territories.

EIGHT PRINCIPLES FOR TERRITORIAL FORMULA FINANCING

Responsibility and accountability – to promote territorial fiscal responsibility and accountability for their budget decisions while maintaining the federal government's accountability for federal-territorial fiscal transfers.

Adequacy and comparability – to provide the territorial governments with adequate funds to provide services that are reasonably comparable to those in other Canadian jurisdictions at reasonably comparable levels of taxation, while reflecting the special circumstances in the challenge of providing programs and services to their residents.

Affordability – to ensure affordability for the federal government and thus sustainability over time.

Predictability – to permit both levels of government to project, with an acceptable level of predictability and certainty, the levels of federal/territorial financing in order to promote orderly long- and short-term fiscal planning.

Neutrality – to provide funding through a neutral mechanism, whereby the level of funding is not subject to the discretionary actions of either the territorial or the federal governments.

Stability – to provide stability of funding to meet the special needs resulting from significant fluctuations in territorial own-source revenues and expenditure caused by changes in economic and fiscal conditions.

Flexibility – to provide flexibility to accommodate changes with provisions to allow for adjustments to accommodate the implementation of Aboriginal self-government, federal initiatives, and further federal program devolution.

Sound incentives – to avoid disincentives for revenue increases on the part of the territorial governments and to provide appropriate incentives for the territorial governments to promote economic development, expand revenue sources, address social issues and foster self-sufficiency.

The Panel's Recommendations

1. REPLACE THE FIXED POOL UNDER THE NEW FRAMEWORK WITH A FORMULA-DRIVEN APPROACH, PROVIDING THREE SEPARATE GAP-FILLING GRANTS TO THE TERRITORIES.

Through its review, the Panel heard several consistent and compelling messages:

- The idea of a fixed pool does not work for the territories; pitting one territory against another is in no one's best interests.
- The differences among the territories are substantial and should be reflected in the overall design of the TFF program.
- The original concept of TFF was to fill the gap between expenditure needs and revenue capacity and this general approach continues to be sound.

Most submissions, including the Joint Submission from the three territories, agreed that the underlying basic formula approach that had been used from 1985 to 2004 was sound and should be retained.[29] The Panel agrees.

Most submissions, including the Joint Territorial Submission, agreed that the underlying basic formula approach that had been used from 1985 to 2004 was sound and should be retained. The Panel agrees.

2. ADDRESS CONCERNS WITH THE ADEQUACY OF TERRITORIAL FORMULA FINANCING THROUGH AN ADJUSTMENT TO THE GROSS EXPENDITURE BASES FOR EACH OF THE TERRITORIES TO CREATE NEW OPERATING BASES.

Perhaps the most consistent concern the Panel heard was that TFF funding was inadequate, particularly given the unique challenges and the higher costs of providing public services in the territories.

The GEBs for each of the territories should be adjusted to reflect funding increases in the New Framework.

In the New Framework, additional funding was allocated to TFF ($100 million in 2004–05 and another $100 million in 2005–06). The Panel recommends that the GEBs for each of the territories should be adjusted to reflect these increases. These adjustments will go a long way to accommodating the territories' concerns about the adequacy of TFF base funding.

[29] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 29.

The Panel also recommends that the GEBs be renamed "New Operating Bases" for each territory. This would effectively set a new base for each territory. The additional funding provided to the territories through the New Framework means that the previous GEBs are no longer proxies for historical expenditure needs.

3. SIMPLIFY THE TFF FORMULA BY MEASURING REVENUE CAPACITY USING A REPRESENTATIVE TAX SYSTEM (RTS).

The Panel considered a number of different approaches for measuring revenue-raising capacity in TFF including using actual revenues adjusted as in the previous formula, using a Representative Tax System (RTS), and so-called "macro" measures.

The RTS is a better way to measure revenue capacity than the number of adjustments included in the previous TFF formula.

In the previous TFF formula, revenue capacity was measured using a number of different calculations and adjustments including a Tax Effort Adjustment Factor (TEAF — Keep-Up Factor, Catch-Up Factor, and Northern Discount Factor) and an Economic Development Incentive.

In the Panel's view, there are a number of difficulties with this approach, including the lack of clear incentives, undue complexity, and lack of transparency. Concerns have been expressed about complexity and inconsistencies in the measurement of revenues in the TFF formula, particularly with respect to the TEAF. Also, in the Panel's view, there is no evidence that any of the adjustments to revenues used in the previous TFF formula accurately reflect territorial tax effort or the capacity for the territories to raise their own revenues. And it is debatable whether accuracy is improved by using actual revenues adjusted by a number of factors.

An RTS approach and National Average Tax Rates should be used to measure revenue capacity.

The Panel also rejected the use of macro measures for the territories. Although macro measures have the advantage of being broader based, they equate a jurisdiction's revenue capacity with its taxpayers' ability to pay taxes. They do not reflect either actual taxing practices or the ability of that jurisdiction to raise revenues.

Consistent with the approach used in the Equalization program, the Panel recommends that an RTS approach and National Average Tax Rates be used to measure revenue capacity. An RTS approach takes into account both the ability to raise revenues as well as the willingness of governments to tax. This approach provides a number of benefits for both the territories and the federal government, including reasonable comparability, administrative simplicity, greater transparency, and sound incentives. In the Panel's view,

the RTS is a better way to measure revenue capacity than the number of adjustments included in the previous TFF formula. Furthermore, it provides appropriate incentives for territories to tax at levels comparable to the national average.

4. FURTHER SIMPLIFY THE MEASUREMENT OF REVENUE CAPACITY BY ESTABLISHING A REVENUE BLOCK THAT INCLUDES SEVEN OF THE LARGEST OWN-SOURCE REVENUES FOR THE TERRITORIES.

Seven of the largest tax bases should be used to calculate each territory's revenue capacity. That would include: personal income tax, corporate income tax, payroll tax, gas, diesel, tobacco, and alcohol tax revenues.

In the territories' Joint Submission to the Panel, one of the options for measuring revenue capacity involved using five tax bases to establish a measure of revenue capacity. Payroll taxes, property taxes, and alcohol taxes were excluded, primarily due to problems in measuring these tax bases appropriately.

The Panel recommends that seven of the largest tax bases be used to calculate each territory's revenue capacity for the Revenue Block to be included in TFF. That would include: personal income tax, corporate income tax, payroll tax, gas, diesel, tobacco, and alcohol tax revenues.

In the Panel's view, the use of seven tax bases is warranted since it reflects sound incentives and meets the principle of measuring revenue capacity without introducing undue complexity. While five tax bases would cover between 36 and 64 percent of the territories' own-source revenues, these seven tax bases represent between 45 and 67 percent of their own-source revenues.[30] Including less than 100 percent of a territories' revenues in TFF is appropriate and reflects the lower capacity of the territories to raise revenues from non-resource tax bases.

5. IMPROVE THE INCENTIVES FOR THE TERRITORIES TO RAISE THEIR OWN REVENUES BY INCLUDING ONLY 70 PERCENT OF TERRITORIES' MEASURED REVENUE CAPACITY IN THE FORMULA.

In their Joint Submission, the territories indicated that the 20 percent Economic Development Incentive (EDI) has resulted in only a small net fiscal benefit for the Northwest Territories and it has had no benefit for either Yukon or Nunavut. These results indicate that the EDI is not a very effective

[30] This proportion is based on 2005–06 Revised Estimates of revenues for each territory from each of the three territories 2006–07 budgets.

Seventy percent of the value of the Revenue Block would be included in TFF, with no other adjustments on the revenue side.

incentive for territories to promote economic development and grow their own-source revenues. In addition, the net fiscal benefit is difficult to predict because it depends on a number of factors beyond the territories' control. The TEAF is also a source of ongoing friction between the territorial and federal governments and its impact and accuracy are debatable. And it is uncertain whether the Northern Discount Factor accurately reflects the reduced ability of the territories to raise revenues because of the higher cost of living in the North.

The Panel's new approach simplifies the measurement of revenue capacity in TFF by eliminating all of the current adjustments on the revenue side. To determine the value of the Revenue Block to be included in TFF, 70 percent of the seven territorial tax bases measured at National Average Tax rates would be included, with no other adjustments on the revenue side.

This approach provides sound and transparent incentives for the territories to promote economic development, expand revenue sources, address social issues, and foster self-sufficiency.

In effect, this results in an Economic Development Incentive of 30 percent. Each territory also gets to keep all its own-source revenues from tax bases that are not measured or included in the formula without seeing a corresponding drop in its TFF grant. This approach provides sound and transparent incentives for the territories to promote economic development, expand revenue sources, address social issues, and foster self-sufficiency.

The Panel also considered the treatment of other revenue sources in measuring revenue capacity for TFF, including other federal transfers. The Panel believes that the territories should be treated in a manner similar to the provinces with respect to other federal transfers. The Panel recommends that any increases in other federal transfers to the territories (e.g. Canada Health Transfer, Canada Social Transfer) that are provided outside of TFF should not be included in the measure of revenue capacity for calculating TFF entitlements.

The territories should benefit from the devolution of responsibilities for natural resources from the federal government to the territories. In principle, the net fiscal benefit to each of the territories should be similar.

6. EXCLUDE RESOURCE REVENUES FROM THE CALCULATION OF REVENUES INCLUDED IN TERRITORIAL FORMULA FINANCING.

As noted earlier, unlike provinces with natural resources within their borders, the federal government has Constitutional authority for natural resource development and management in the three territories.

All three territories see natural resources as a key source of substantial economic development opportunities. But agreements on devolution and resource revenue sharing with the federal government are in place only in Yukon. Discussions with the other two territories are in progress.

In principle, the Panel believes that the territories should benefit from the devolution of responsibilities for natural resources from the federal government to the territories. In principle, the net fiscal benefit to each of the territories should be similar.

The new approach to TFF recommended by the Panel is flexible enough to accommodate any devolution and resource revenue sharing agreements in the territories.

The new approach to TFF recommended by the Panel is flexible enough to accommodate the devolution and resource revenue sharing agreements currently in place in Yukon. In Yukon's case, it means that resource revenues would continue to be addressed outside TFF. A number of approaches to devolution and resource revenue sharing in the Northwest Territories and Nunavut could be accommodated in the Panel's new approach.

7. USE THE NEW OPERATING BASES AS APPROXIMATE MEASURES OF EXPENDITURE NEEDS.

There's a general understanding and much anecdotal evidence to show that both costs and needs are substantially higher in the territories compared with southern Canada. But there are few consistent, measurable, and evidence-based indicators of expenditure needs in the territories.

Since the TFF formula was first established, expenditure need was determined based on what the territories spent in 1982–83 then adjusted annually by the PAGE escalator. The Panel heard that the GEBs used in the previous TFF formula was not a real measure of expenditure need, but simply an approximation based on historical information dating back to when TFF was first established. There also is concern about how to translate expenditure needs and cost measures into a TFF formula.

The Panel believes that while a study of expenditure needs and the cost of providing services in the Territories may be useful in the longer term, it would be complex, costly, and time-consuming.

Some have suggested that there should be a systematic and thorough study done of expenditure needs in the territories to establish new expenditure bases and to determine how much money is adequate to meet the territories' needs. Similar work is done in Australia, where the Commonwealth Grants Commission collects and compiles ongoing evidence of spending and needs in each of the Australian states.[31]

On balance, the Panel believes that while a study of expenditure needs and the cost of providing services in the territories may be useful in the longer term, it would be complex, costly, and time-consuming. And it is questionable whether this extensive work would result in any better measures of what the territories need than a combination of history, political judgements, and proxy measures. For these reasons, the Panel suggests that an extensive and

[31] Government of Australia, Commonwealth Grants Commission. (2006). *2006 Update Report, Introduction*.

Evidence of the costs of providing public services in the territories should be compiled on an ongoing basis and reported in an annual report to Parliament.

detailed study of expenditure needs in the territories may not be useful at this time. The Panel also recommends that evidence of the costs of providing public services in the territories be compiled on an ongoing basis and reported in an annual report to Parliament.

Further information on expenditure need is provided in Annex 2.

8. UNDERTAKE A REVIEW OF SIGNIFICANT EXPENDITURE NEEDS AND HIGHER COSTS OF PROVIDING PUBLIC SERVICES IN NUNAVUT.

The case for assessing expenditure needs in Nunavut is substantially different. Initial evidence points to serious disparities in outcomes for health, education, housing, and social well-being compared with other Canadians.

While the Panel does not recommend an extensive study of expenditure needs in the territories in order to adjust the funding base for TFF, information reviewed by the Panel clearly indicates that the case for assessing expenditure needs in Nunavut is substantially different. Initial evidence points to serious disparities in outcomes for health, education, housing, and social well-being compared with other Canadians. Nunavut is a new government with many challenges including the need to build the necessary capacity, particularly in public administration, to provide adequate and effective programs and services, and, at the same time, meet expectations for transparency and accountability in government.

When Nunavut was established as a territory on April 1, 1999, TFF funding was not designed (nor was it adequate) to address existing deficiencies in health, housing, education, and social infrastructure, programs, and services. The Panel's recommendations on TFF are intended to provide adequate funding for all three territories through both an initial adjustment to each funding base and ongoing escalation in TFF funding tied to relative growth in population in each of the territories. However, these adjustments do not sufficiently address the challenges and gaps in Nunavut.

Further work should be done to assess expenditure needs in Nunavut as a starting point for addressing those needs on an urgent basis.

For that reason, the Panel recommends that further work be done to assess expenditure needs in Nunavut as a starting point for addressing those needs on an urgent basis. This study could provide a template for reviewing expenditure needs and costs in the other territories in the longer term. However, the immediate objective should be to identify the specific needs and costs in Nunavut and to determine the most appropriate actions to be taken. The Government of Nunavut and the federal government should undertake this work jointly. Any additional funding necessary to address the challenges in Nunavut should be provided through targeted programs rather than through adjustments to the TFF formula.

9. ADJUST THE NEW OPERATING BASES ANNUALLY BY THE RELATIVE GROWTH IN POPULATION IN THE TERRITORIES AND GROWTH IN PROVINCIAL AND LOCAL SPENDING (PAGE).

The Joint Territorial Submission and other submissions made a strong case that the 3.5 percent annual escalation of TFF funding built into the New Framework was inadequate and inappropriate. They also contend that a fixed growth rate is not responsive to changes in population growth, expenditure needs, or the cost of providing public services in the territories. In the Panel's view, the 3.5 percent annual growth rate is affordable and is in line with long-term growth in federal revenues.

The Panel recommends a separate Population-Adjusted Gross Expenditure Escalator (PAGE) be used to determine annual adjustments for each of the territories.

Historically, a Population-Adjusted Gross Expenditure Escalator (PAGE) was used to determine annual adjustments to the GEBs of each of the territories. In the 10 years prior to the introduction of the New Framework, the average formula escalator (PAGE) was 3.2 percent.[32]

The Panel recommends that a separate Population-Adjusted Gross Expenditure Escalator (PAGE) be used to determine annual adjustments to the New Operating Bases for each of the territories. In their Joint Submission, the three territories indicated that this escalator is a reasonable measure of changes in their expenditure needs, if it is measured separately for each territory and there is no ceiling. To ensure that it is responsive to changing circumstances in each of the territories, the Panel recommends that the PAGE escalator remain open for three years in order to adjust for population changes.

The Panel recommends that the PAGE escalators remain open for three years in order to adjust for population changes.

It is difficult to predict the future impact of the PAGE escalators due to the variability in its components. But it is unlikely that, on average, the PAGE would grow at a much faster rate than in the past, particularly since population growth rates may be slowing in the Northwest Territories and Yukon. For this reason, the Panel believes that the PAGE escalators will continue to be affordable in the medium-term for the federal government.

10. IMPROVE STABILITY AND PREDICTABILITY BY USING THREE-YEAR MOVING AVERAGES.

The approach recommended by the Panel may not provide as much stability or predictability as the New Framework with its fixed pool and fixed annual escalation rate. To address this ongoing concern, the Panel recommends that three-year moving averages continue to be used to calculate the PAGE

Three-year moving averages should continue to be used to calculate the PAGE escalators, as in the previous TFF formula.

[32] Data provided by Finance Canada.

escalators, as in the previous TFF formula. Under this approach, the territories and the federal government share both the upside and downside financial risks of changes in the territorial economies.

11. ADDRESS ISSUES OF GOVERNANCE, ACCOUNTABILITY, DISPUTE RESOLUTION, AND RENEWAL THROUGH AN EXPANDED AND MORE TRANSPARENT PROCESS.

The Panel heard from the private sector and Aboriginal leaders that timely resolution of devolution and resource revenue sharing issues is critical to provide a more stable and certain investment climate necessary to promote economic development in the territories.

The Panel heard several concerns about the lack of transparency in the TFF process, about discussions held and changes made behind closed doors, and about the lack of timeliness in getting issues addressed and resolved. Moreover, the Panel heard from the private sector and Aboriginal leaders that timely resolution of devolution and resource revenue sharing issues is critical to provide a more stable and certain investment climate necessary to promote economic development in the territories.

The Panel considered the option of establishing an independent governance mechanism for TFF. On the one hand, an independent commission could provide increased visibility, neutrality, and credibility to the decision-making process. It could provide an unbiased process for resolving disputes, produce regular reports, or engage in ongoing research on issues such as assessing expenditure needs.

On the other hand, there are concerns with accountability from both federal and territorial governments. TFF, like Equalization, is a federal program. Consequently, an independent commission could only make recommendations to the federal government, not make final, binding decisions. In terms of the territories, there is potential for an independent commission to further delay decisions. Information on commissions in other countries suggests that they are costly, can require substantial administrative structures, and can negatively affect efficiency.

The Panel recommends that the territories and the federal government continue to use the current process for discussing and revising TFF.

The Panel therefore recommends that the territories and the federal government continue to use the current process for discussing and revising TFF. In particular, the Panel believes that a five-year renewal period for TFF is sufficient to ensure that ongoing changes in territorial circumstances are reflected in TFF. This approach is likely the best reflection of Canada's federation. While there have been problems in the past, particularly with timeliness, this approach has served Canada well and should be retained.

At the same time, the Panel believes that several steps should be taken to improve the transparency and accountability of the current process for discussing TFF among the federal and territorial governments.

- **The new approach to TFF should be legislated, rather than addressed through agreements between the territories and the federal government.**

  The New Framework introduced in October 2004 was the first time TFF was legislated and the Panel believes this provides significant benefits to both the territories and the federal government. It minimizes the chance of ad hoc changes to the program. It increases transparency for all Canadians, including northerners. And it provides opportunities for both public and Parliamentary reviews of the program at regular renewal periods.

Several steps should be taken to improve the transparency and accountability of the current process for discussing TFF among the federal and territorial governments.

- **Annual reports on TFF should be required from the federal government and those reports should be tabled in Parliament.**

  Although TFF is discussed in the context of the federal government's budget, there is very little visibility for TFF in spite of its importance to the territories. The Panel recommends that the federal Minister of Finance table an annual report on TFF in Parliament that would address such things as:

  - The history of the TFF program and its current design
  - The total amount of funding provided to TFF as well as other federal transfers provided to the territories
  - The amount of TFF allocated to each of the three territories and how that funding allocation was determined
  - Comparisons of TFF total funding and allocations to territories over time, particularly comparisons with previous renewal periods
  - Any changes in how the program is structured or designed
  - A list and current status of any outstanding issues between the federal government and the territories
  - Key indicators of expenditure needs, costs of providing public services, and revenue capacity in the territories

  The territories may want to consider tabling similar reports in their respective legislative assemblies as part of their budget processes.

The Panel recommends that the federal Minister of Finance table an annual report on TFF in Parliament.

- **Prior to the regular, five-year renewal of TFF, Finance Canada should issue a discussion paper identifying key issues and proposed changes to TFF. This should be accompanied by an open, Parliamentary committee review process.**

  Too often, the Panel heard that decisions about changes to TFF and Equalization are made behind closed doors, with discussions taking place at the officials level. There is no doubt that many issues can be and are successfully resolved through discussions among officials from both territorial and federal governments. However, the result is very little open public discussion and debate about TFF, little awareness of the nature of changes, and intermittent public squabbling when agreement can't be reached at the political level.

  The Panel believes that a more open process would be beneficial to both federal and territorial governments, to northerners who see the impact of adequate or inadequate resources, and to all Canadians who want to know how their taxes are being used and what benefits are achieved.

  In addition to a commitment to a five-year renewal of TFF, a discussion paper would highlight useful background information, issues, and options. It would provide the federal government with an opportunity to raise important issues for public discussion. It would provide an opportunity for territories and interested Canadians to state their own cases publicly and openly. And a Parliamentary review process would also give all parties a forum to state their views.

A more open process would be beneficial to both federal and territorial governments, to northerners who see the impact of adequate or inadequate resources, and to all Canadians who want to know how their taxes are being used and what benefits are achieved.

Benefits of the Panel's new approach

- It reflects eight principles including: responsibility and accountability, adequacy and comparability, affordability, predictability, neutrality, stability, flexibility, and sound incentives.
- There is a clearer incentive for territories to increase their own sources of revenues. This supports the shared goals of self-sufficiency and self-reliance and will benefit all Canadians.

- The Panel's new approach means more funding for TFF. Based on some initial indicators, additional funding is required for the territories to meet pressing needs in key program areas and to achieve the goal of providing reasonably comparable services. At the same time, the Panel urges territorial governments to continue to seek the most efficient ways of providing essential services and managing growing costs of public services.
- It addresses the recent sources of conflict between the federal government and the territories and provides a number of significant improvements to a formula-based approach for TFF.
- It continues to recognize the very real diversity among the territories. It builds on the positive elements of TFF and includes a separate gap-filling formula and specific escalator for each territory.
- The proposed approach to governance should bring more accountability, transparency, visibility, and timeliness to negotiations and to the renewal process for TFF.
- While it's still complex, the program is simpler than the previous TFF formula and will reduce some of the administrative burden on both territorial and federal governments.
- The Panel's new approach is flexible enough to accommodate adjustments to funding due to federal initiatives and program transfers, existing and future agreements arising from Land Claims and Aboriginal self-government, and devolution and resource revenue sharing agreements among the territories, First Nations, Aboriginal organizations, and the federal government.
- The simplified TFF has a number of added benefits including a clearer understanding of the financial circumstances of the territories and more certainty for potential investors. In turn, this should support economic development in the North and help secure Canada's sovereignty over the Arctic.

The Panel's new approach means more funding for TFF. At the same time, the Panel urges territorial governments to continue to seek the most efficient ways of providing essential services and managing growing costs of public services.

The simplified TFF has a number of added benefits including a clearer understanding of the financial circumstances of the territories and more certainty for potential investors. In turn, this should support economic development in the North and help secure Canada's sovereignty over the Arctic.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

ASSESSING THE FINANCIAL IMPACT

Throughout its deliberations and discussions, the Panel has learned that principles, directions, and best intentions are one thing. What people really want to know is the bottom line. What are the financial implications of the Panel's new approach?

To assess the fiscal impact, the Panel compared the results of its new approach with the TFF entitlements for the territories under the New Framework, as well as forecasts of funding the territories would have received under the previous TFF formula. Further information on the financial impact of the Panel's recommendations is contained in Annex 4.

Comparison with the New Framework

- The Panel's approach provides more funding to the territories than the legislated New Framework. This is due to the combined effect of adjustments to the GEBs for the territories, the reintroduction of the PAGE escalator, and the simplified measure of revenue capacity.
- Under the legislated New Framework, total TFF funding is $2.14 billion in 2007–08. In 2007–08, the Panel's approach means an additional $60 million for the territories.
- Over the five years from 2005–06 to 2009–10, the total amount of funding for TFF would increase by $285 million compared with the New Framework. To put that in perspective, the Panel's approach would increase funding for TFF by about 20 percent over five years while the New Framework would increase funding by about 15 percent.

TABLE 2 – Comparison of the Panel's Approach with the New Framework, 2005–06 to 2009–10

	$ million					
	2005–06	**2006–07**	**2007–08**	**2008–09**	**2009–10**	**Total**
Panel's Approach	2,000	2,098	2,203	2,304	2,406	**11,011**
New Framework	2,000	2,070	2,143	2,218	2,295	**10,726**
Difference	0	28	60	86	111	**285**

Comparison with TFF entitlements announced for 2006–07

- Each of the territories would receive additional funding under the Panel's approach compared with the 2006–07 TFF entitlements announced in November 2005. Compared with announced TFF entitlements for 2006–07, under the Panel's approach, the Northwest Territories would receive an additional $53 million, Nunavut an additional $53 million, and Yukon an additional $26 million in 2007–08.
- On a per capita basis, the Panel's approach translates into $18,148 per capita in the Northwest Territories, $29,165 per capita in Nunavut, and $17,114 per capita in Yukon in 2007–08.

TABLE 3 – Comparison of the Panel's Approach for 2007–08 with Announced Entitlements for 2006–07, by Territory

	$ million / $ per capita		
	Northwest Territories	**Nunavut**	**Yukon**
Panel's Approach for 2007–08			
Total Entitlements	791	880	532
Per Capita Entitlements	18,148	29,165	17,114
Announced Entitlements for 2006–07			
Total Entitlements	738	827	506
Per Capita Entitlements	17,107	27,617	16,335
Difference			
Total Entitlements	***53***	***53***	***26***
Per Capita Entitlements	***1,041***	***1,548***	***779***

Note: Totals may not add since figures have been rounded up to the nearest million. TFF entitlements for 2006–07 were announced by the federal Minister of Finance in November 2005, based on October 2005 data.

Comparison with the previous TFF formula

- For 2007–08, each of the territories would receive more under the Panel's approach than under the previous TFF formula. The Northwest Territories would receive $40 million more, Nunavut would receive $48 million more, and Yukon would receive $35 million more.

TABLE 4 – Comparison of the Panel's Approach with TFF Formula for 2007–08

	$ million / $ per capita		
	Northwest Territories	**Nunavut**	**Yukon**
Panel's Approach			
Total Entitlements	791	880	532
Per Capita Entitlements	18,148	29,165	17,114
TFF Formula			
Total Entitlements	751	832	497
Per Capita Entitlements	17,231	27,574	15,988
Difference			
Total Entitlements	***40***	***48***	***35***
Per Capita Entitlements	***918***	***1,591***	***1,126***

- Over five years from 2005–06 to 2009–10, the territories would receive $549 million more under the Panel's approach than under the previous formula.

TABLE 5 – Comparison of the Panel's Approach with TFF Formula, 2005–06 to 2009–10

	$ million					
	2005–06	**2006–07**	**2007–08**	**2008–09**	**2009–10**	**Total**
Panel's Approach	2,000	2,098	2,203	2,304	2,406	**11,011**
TFF Formula	1,901	2,010	2,080	2,183	2,288	**10,462**
Difference	99	88	123	121	118	**549**

ADDRESSING OUTSTANDING ISSUES

ADDRESSING OUTSTANDING ISSUES

For the past year, members of the Panel have been immersed in all manner of issues related to Equalization and TFF—everything from details of how the programs work, to models used in other countries, academic analyses and ideas, complex formulas, and detailed simulations. In the case of TFF, many of us have come to know more about the North than we ever imagined before this experience.

Not surprisingly, we've learned about issues that extend well beyond the mandate of this Panel. We've heard about the hopes and dreams of people to ensure that the North reaches its full potential. We've heard frustrations about current living conditions in some parts of the territories and serious problems with education, health, suicide, and a whole range of social issues that, quite frankly, can no longer be ignored. We've talked with territorial leaders and officials about the importance of TFF to their current and future plans. We've heard from federal officials who understand the challenges of the territories and have sincerely tried to address those challenges through changes to TFF and other federal programs.

"In my view as a Conservative, Canadians need to act with conviction and courage. We must exercise federal jurisdictional authority in the North and assert our sovereignty to protect and advance the interests of the Canadians who live there. We must take immediate action to devolve governance and resource-sharing authority to the territorial, aboriginal and local governments of the North..."

- The Honourable Jim Prentice, P.C., M.P. [33]

The Panel cannot end its report without at least commenting on some of these broader issues.

First, we heard that discussions regarding devolution and resource revenue sharing agreements between the federal and territorial governments (particularly in the Northwest Territories) have been delayed while the work of the Panel was under way. We strongly encourage governments and Aboriginal leaders to resume negotiations and reach agreements. The potential for resource developments in the territories is perhaps the best opportunity they have to achieve their dream of self-sufficiency and self-reliance. Provinces with rich natural resources are able to benefit from those resources. The same principle of net fiscal benefit should apply to the territories.

Second, as noted at the outset of this report, there's a strong sense that the North is in a fragile state of transition. The promise of substantial economic development is just starting to be realized, but clearly there will be costs involved. In many respects, the lack of sufficient infrastructure combined with serious challenges in health care and education and a host of other social issues may well be a serious barrier to economic development. And the risk that too many northerners, particularly Aboriginal and Inuit people, are ill-prepared to benefit from the anticipated prosperity economic development can bring, is very real indeed. To put it bluntly, these are issues

The goal of providing reasonably comparable public services to people in the territories has to be met through a combination of adequate federal support, active promotion of economic development in the territories, and sound financial management.

[33] The Honourable Jim Prentice. (2005). Lost in the Arctic, in *Diplomat and International Canada*, May-June 2005, p. 19.

that TFF alone cannot address. For the foreseeable future, it's likely that there will be mounting pressure on the federal and territorial governments to work together to address these issues either within or outside of TFF.

Third, the situation in Nunavut is serious and demands attention. In part, these are structural gaps that date back to when Nunavut was established. But the initial evidence is there and cannot be ignored. Without urgent concerted action to improve housing, health, education, and quality of life for people living in Nunavut, particularly Inuit people, there is little hope that things will change for the better. The Panel urges the Government of Nunavut, the Government of Canada, Inuit leaders, and a wide range of organizations, groups, and agencies to come together to address these issues before the situation gets even worse.

"Many countries-and they are to be envied-possess in one direction or another a window which opens out on to the infinite-on to the potential future.... The North is always there like a presence, it is the background of the picture, without which Canada would not be Canadian."

- André Siegfried[35]

Fourth, the Panel understands that the costs are higher and the challenges of delivering public services are more complex in the territories. At the same time, like all governments across Canada, the territories must continually search for the most innovative, effective, and efficient ways of meeting their citizens' needs at a cost their taxpayers can afford. The goal of providing reasonably comparable public services to people in the territories has to be met through a combination of adequate federal support, active promotion of economic development in the territories, and sound financial management.

The Panel heard about the need to embrace and work together to achieve a strong vision for the future of Canada's territories. And we encourage the federal government and all Canadians to support that vision and help make it a reality.

Finally, the Panel heard about the need to embrace and work together to achieve a strong vision for the future of Canada's territories. As outlined in the Joint Federal-Territorial Northern Strategy:

> *The North is a place where self-reliant individuals live in healthy, viable communities, and where northerners manage their own affairs. It is a place where strong, responsive governments work together to build a prosperous, vibrant future for all. It is a place where northern traditions of respect for the land and environment are cherished, and actions and decision-making are anchored in the principles of responsible, sustainable development. It is a place where citizens celebrate their diversity. The North is a place where the territories and their governments are strong contributing partners in a dynamic and secure federation.*
>
> - Joint Federal-Territorial Northern Strategy
> Nation-Building: Framework for a Northern Strategy[34]

The Panel believes that this new approach to TFF will accommodate and support this vision. A vision that will take the territories beyond the "fragility" of today to a strong and self-reliant future. A vision that will fulfill the promise of economic development and create a better quality of life for northerners. And we encourage the federal government and all Canadians to support that vision and help make it a reality.

[34] Government of Canada. (2004). *Nation-Building, Framework for a Northern Strategy*, p. 1.
[35] Government of Canada. Mr. Justice Thomas R. Berger. (1977). *Northern Frontier, Northern Homeland, The Report of the Mackenzie Valley Pipeline Inquiry: Volume One*, p. 197.

ACHIEVING A NATIONAL PURPOSE

Improving Territorial Formula Financing and Strengthening Canada's Territories

ANNEXES

Annex 1: List of Canadians Consulted

(Submissions were received from those in italics)

Roundtable Participants

The Honourable Peter Lougheed, P.C., Alberta
The Honourable Erik Nielsen, P.C., British Columbia

Assiniwi, Jean-Yves, Northwest Territories
Banta, Russell, Ontario
Braden, George, Ontario
Cameron, Kirk, Yukon
Cox, Douglas, Nunavut
Dehtiar, Eitan, Northwest Territories
Eegeesiak, Okalik, Ontario
Evans, Maurice, Northwest Territories
Feehan, James, Newfoundland and Labrador
Fingland, Frank, British Columbia
Goreman, Margaret, Northwest Territories
Graham, Joan, Yukon
Kusugak, Jose, Nunavut
Lantz, Tanya, Northwest Territories
Long, Robert, Nunavut
Ng, Kelvin, Alberta
Nielsen, Eric, British Columbia
Noël, Stanley, Yukon
Olson, Michael, Northwest Territories
Ottenbreit, Randy, Alberta
Paulette, Michael, Ontario
SanGris, Jonas, Northwest Territories
Timar, Hal, Nunavut
Tucker, David, Northwest Territories
Webber, Sally, Yukon
Zuker, Richard, Ontario

Government Representatives (some of whom participated in the Roundtable)

The Honourable Dennis Fentie, Premier and Minister of Finance, Government of Yukon
The Honourable Floyd K. Roland, Deputy Premier and Minister of Finance, Government of the Northwest Territories
The Honourable David Simailak, Minister of Finance, Government of Nunavut

Anderson, Barbara, Assistant Deputy Minister, Department of Finance, Government of Canada
Bluck, Kelly, Government of the Northwest Territories
Bennett, Ian, Deputy Minister of Finance, Government of Canada
Boothe, Paul, former Associate Deputy Minister of Finance, Government of Canada
Boudreau, Mark, Government of Nunavut
Devana, David, City of Yellowknife
Grant, Glenn, Government of Yukon
Hartmann, Erich, Government of Ontario
Haynes, Dale, Government of Nunavut
Hines, Pamela, Deputy Minister of Education, Government of Nunavut
Horsman, Nancy, Government of Canada
Hrycan, David, Government of Yukon

Lalande, Christopher, Government of Nunavut
Lapshina, Svetlana, Government of Nunavut
Lawrance, James, Indian and Northern Affairs, Government of Canada
Lévesque, Louis, Associate Deputy Minister of Finance, Government of Canada
MacDonald, Daniel, Government of Canada
McLennan, Bruce, Deputy Minister of Finance, Government of Yukon
Melhorn, Margaret, Deputy Minister of Finance, Government of the Northwest Territories
Monroe, John, Government of the Northwest Territories
Morehen, Tony, Government of Alberta
Nightingale, David, Government of the Northwest Territories
Okpik, Kathy, Deputy Minister of Human Resources, Government of Nunavut
Omilgoitok, David, Deputy Minister of Intergovernmental Affairs, Government of Nunavut
Reddy, Paul, Government of Nunavut
Scott, Peter, President and Chief Executive Officer, Nunavut Housing Corporation, Government of Nunavut
Shoniker, Timothy, Government of Yukon
Sitland, Douglas, Government of Nunavut
Sparling, Gabriela, Deputy Minister of Aboriginal Affairs, Government of the Northwest Territories
Stewart, David, Government of the Northwest Territories
Steele, Gordon, Government of Yukon
Suvega, Pauloosie, Assistant Deputy Minister, Department of Finance, Government of Nunavut
Tootoo, Victor, Assistant Deputy Minister, Department of Finance, Government of Nunavut
Vardy, Robert, Deputy Minister of Finance, Government of Nunavut
Walsh, John, Deputy Minister to the Executive and Secretary to Cabinet, Government of Nunavut
Winslow, Blake, Government of the Northwest Territories
Won, Jason, Government of Canada

Others Who Were Consulted or Prepared Submissions

Gusen, Peter, Ontario
Inuvialuit Regional Corporation
Kitchen, Harry, Ontario
MacNevin, Alex, Nova Scotia
Northwest Territories Aboriginal Summit
Northwest Territories Chamber of Commerce
Northwest Territories Construction Association
Nunavut Association of Municipalities/Nunavunmi Nunaliit Katojikatigiigit
Parker, John H., British Columbia
Robinson, T. Russell, Ontario
Shah, Anwar, United States
Slack, Enid, Ontario
Todd, John, Alberta

Annex 2: Some Evidence of Expenditure Needs and the Costs of Providing Public Services in the Territories

In its mandate, the Panel was asked to identify indicators of the cost of providing public services in the territories that would be relevant to evaluating Territorial Formula Financing (TFF) funding levels. As indicated in the Panel's Report, the benchmark Gross Expenditure Bases (GEBs) established in 1985 in Yukon and the Northwest Territories reflected the reality that expenditure needs were high in the two Territories. This was also taken into account in the establishment of Nunavut's GEB beginning in 1999-00. TFF grants to the territories continue to be substantially higher per capita than Equalization payments to receiving provinces in recognition that expenditure needs are much higher in the territories compared with the provinces. In spite of this, during their consultation process, the Panel heard from the three territories and other commentators that the key issue for the territories remains the overall adequacy of TFF funding to meet expenditure needs.

In view of these concerns, the Panel reviewed evidence of expenditure need (volume and costs) in the three territories compared with Canadian averages and selected indicators of health and social well-being in the territories. In the Panel's view, there is sufficient evidence of higher than average expenditure needs to warrant the increase in TFF funding recommended by rebasing the GEBs. However, in the Panel's view, expenditure needs in Nunavut are substantially different than in the other two territories.

This annex summarizes issues related to expenditure needs and includes a review of a number of potential indicators of expenditure needs that may be relevant to evaluate TFF funding levels in future.

What is expenditure need?

Expenditure need refers to the ability of governments to finance their responsibilities after taking into account factors that affect the volume of services provided and the cost of providing those services.

- **The Volume of Public Services.** A jurisdiction with many young or elderly people who require expensive health care, or many school-aged children who require education has a high demand or need for public services. Experts often refer to this as a high workload. It is often measured by the socio-demographic and economic characteristics of a jurisdiction's population.

- **The Cost of Providing Services.** Some jurisdictions face higher costs of delivering public services because of higher wages, higher property and material costs, the need to serve remote or sparsely populated areas, and, sometimes because they are less efficient or are ineffective in delivering public services.

These factors do not take into account other factors that are within the control of a government, such as societal preferences.

ANNEX 2

How is expenditure need measured?

There are a number of ways to measure expenditure need, ranging from a population proxy approach to a more complex representative expenditure system (RES) approach. Examples of methods used to measure expenditure need and revenue capacity around the world are the Barnett Formula in the United Kingdom, the RES in Australia, and the TFF in Canada's three territories.

Introduced in 1978, the Barnett Formula automatically applies a share of any change in program spending in England compared with Scotland and Wales to the expenditure base for the two jurisdictions. There are two components to the expenditure base in Scotland and Wales: historical expenditures in place before devolution of responsibilities and incremental expenditure changes. The Barnett Formula determines only the second element of the expenditure base. The formula does not allocate expenditure on the basis of comparative need and does not take into account differences in the cost of providing services.[1] Negotiation and bargaining determine funding levels, primarily on the basis of population share, change in planned spending, and comparability of programs. This is not a comprehensive expenditure need formula.

The RES is the expenditure equivalent of the Representative Tax System (RTS) approach. The RTS measures a jurisdiction's fiscal capacity by assessing the revenues that would be raised from a typical or standard revenue regime at average tax rates. Similarly, an RES approach measures the amount it would cost per capita to provide typical services of national average quality, assuming a national average rate of efficiency. For example, a standard basket of programs and services may include health, education, public welfare, infrastructure and housing. One would measure workload and costs in each of these expenditure areas to estimate the cost of providing the standard basket of services. If the amount of funding required is more than the national average, then the jurisdiction would be at a disadvantage compared with others and would receive a higher than average grant.

For example, the measurement of expenditure need for childcare, elementary, and secondary education would require first constructing a basket of education services representative of the average across Canada (i.e., teacher-pupil ratios, availability of special education services, etc.). Then the cost of providing these services across different provinces would be measured, taking into account the workload differences (e.g., proportion of school-aged children, proportion of children requiring special education, proportion of children with English or French as a second language, number of languages in which instruction and school books must be offered). Finally, the differences in the costs of providing this standardized basket of services would be taken into account (e.g., different wage and salary conditions, real estate prices, material costs and diseconomies of scale of serving remote or dispersed communities).

[1] Twigger, Robert.(1998). *The Barnett Formula.* United Kingdom House of Commons Library, Research Paper 98/8, January 12, 1998; Edmonds, Timothy.(2001). *The Barnett Formula.* United Kingdom House of Commons Library, Research Paper 01-108, November 30, 2001; The Scottish Parliament.(2001). *The Barnett Formula*, Research Note no. 31, May 4, 2001, Edinburgh Scotland; Bell, David.(2001). *The Barnett Formula.* Department of Economics, University of Stirling, January 2001.

ANNEX 2

The Australian Commonwealth Grants Commission uses a rigorous RES approach to estimate state expenditure needs. Under the Australian system, there are eleven expenditure categories (education, health, law, order and public safety, welfare, concessions and other payments, culture and recreation, aboriginal community services, general public services, services to industry, transport, and economic affairs and other purposes) that are further subdivided. The equalization entitlement is determined by the following formula: standardized expenditure plus average budget deficit or surplus minus standardized revenue minus specific-purpose grants.[2]

There are a number of significant disadvantages with the RES approach, making it inappropriate for Canada's territories. Among other things, a great deal of judgement is required to determine the average workload for an expenditure area. Also, it would be more difficult in Canada's territories to assess economies of scale or to determine the impact of geography on costs.

Expenditure need in the territories is determined by using an historical expenditure measure that is escalated to reflect relative population growth in the territories compared with Canada as well as changes in provincial and local spending in Canada. It is not a comprehensive RES, but rather approximates expenditure needs over time. The historical expenditure measure, the Gross Expenditure Base (GEB), was established in 1985 and was based on 1982–83 expenditures in Yukon and the Northwest Territories. At that time, the GEBs of the two territories accurately represented territorial expenditure needs. Historical spending patterns can be reasonable indicators of expenditure needs and can continue to be relevant, with some adjustments.

This approach avoids using specific standards for services to determine funding levels, as in the case in Australia, and is much less complex. That said, the calculation of GEBs have become more complex over time due to adjustments that were made to reflect devolution of programs to the territories and the creation of a separate GEB for Nunavut. In the absence of an expenditure need study, the Panel believes that the current GEBs are a reasonable proxy for territorial expenditure needs.

In the previous TFF formula, the GEB escalator attempted to reflect more than population growth by including a measure of comparability with the provinces through the provincial-local expenditure portion. This assumed that the mix of public programs and services is comparable in the provinces and the territories, and that the growth rates in public expenditures are also similar. It is generally accepted that even though the current GEBs are based on 1982–83 revenues of the territorial governments, the GEB escalator is a reasonable reflection of changes in territorial expenditure need.

2 Government of Australia,Commonwealth Grants Commission. (2006). *2006 Update Report*.

Unique circumstances affect the volume and costs of public services in the territories

Some of the unique circumstances and needs in the territories are population growth and structure, climate, and geographically dispersed and isolated communities. These circumstances affect both the volume (workload) and cost of providing public services in the territories.

Population

The table below shows that the population in the territories is younger, on average, than in the rest of Canada. Twenty-three percent of people living in the provinces are under the age of 18, compared with 32 percent in the Northwest Territories and 43 percent in Nunavut.

TABLE 1 – Selected Demographic Statistics in the Territories Compared with the Provincial Average, 2001

	Yukon	Northwest Territories	Nunavut	Provincial Average
Population less than 18 (percent)	26	32	43	23
Population greater than 65 (percent)	6	4	2	13
Aboriginal and Inuit population (percent)	23	51	85	3
Population Growth Rate (1999–00 to 2004–05)	0.3	1.0	2.0	1.0

Source: Statistics Canada, Census 2001

There is a larger proportion of Aboriginal and Inuit people living in the territories, ranging from 23 percent in Yukon, 51 percent in the Northwest Territories, to 85 percent in Nunavut. This is very high compared with the provincial average of three percent of the population.

In the period from 1999–00 to 2004–05, the population growth rate in Nunavut was double the provincial average. A large part of the explanation for the higher growth rate in the population in Nunavut is due to a high birth rate, which is estimated to be 26.3 births per 1,000 people. This is close to three times the Canadian average of 10.5 births per 1,000 people.[3]

Over the medium term, population growth rates in the territories are expected to exceed those in Canada, in particular in Nunavut and among the Aboriginal and Inuit population. As shown in the Table 2, from 2009 to 2019, Nunavut's population is expected to grow by 16.5 percent, compared with 7.1 percent in the Northwest Territories, 3.7 percent in the Yukon and 6.4 percent in Canada as a whole.

[3] Government of Canada, Statistics Canada. (2004). *Births and Birth Rate, by province and territory, projections for 2004–05*; Government of Nunavut, Nunavut Housing Corporation.(2004). Nunavut Housing Corporation and Nunavut Tunngavik Incorporated, *Nunavut Ten-Year Inuit Housing Action Plan*, September 2004.

TABLE 2 – Comparison of Projected Population Growth Rates in the Territories, 2004–2019

	Yukon	Northwest Territories	Nunavut	Provincial Average
Projected Population Growth Rate (2004–2009)	-0.2	7.2	8.3	3.6
Projected Population Growth Rate (2009–2019)	3.7	7.1	16.5	6.4

Source: Statistics Canada, Northwest Territories Bureau of Statistics, Yukon Bureau of Statistics

Climate

On average, the climate is harsher in the territories than in southern Canada. For example, in Toronto, the average temperature is –4 degrees Celsius in January and 22 degrees Celsius in July. In Iqaluit, the average temperature is –27 degrees Celsius in January and 8 degrees Celsius in July. Although these temperatures are not that different on average, winter is longer and extreme low temperatures in winter are more common in the territories.[4]

One of the largest contributors to territorial program expenditures is utility costs. Electricity costs in the territories are high due to the harsh climate and the cost of transporting fuel north to generate electricity. Electricity rates vary significantly among the territories, primarily due to the fuel choice and method of generating electricity.

Electricity rates in the Northwest Territories and Nunavut are, on average, three times as high as in southern Canada. Yukon electricity consumers are much better off due to the development of large hydroelectric projects in the territory. For example, in 2004, provincial hydro rates varied from a low of 6.33 cents per kilowatt-hour in Québec to a high of 9.22 cents per kilowatt-hour in Nova Scotia. In Yukon, residential rates in communities with hydroelectric generation capacity are 13.64 cents per kilowatt-hour, increasing to 15.97 cents per kilowatt-hour in diesel-powered communities to 32.4 cents per kilowatt-hour in Old Crow.[5] In the Northwest Territories, electricity generation is primarily based on diesel power and varies from 11.72 cents per kilowatt-hour in Yellowknife to $2.67 per kilowatt-hour in Colville Lake.[6] In Nunavut, electricity generation is based on diesel power in every community and ranges from a low of 36.8 cents per kilowatt-hour in Iqaluit to 85.62 cents per kilowatt-hour in Kimmirut.[7]

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4 Environment Canada,Meteorological Service of Canada. (2006)., *Canadian Climate Normals, 1971-2000*, various locations.
5 Government of Yukon, Department of Energy, (2005).*Yukon Energy Corporation, 2004 Annual Report*.
6 Government of the Northwest Territories, Northwest Territories Power Corporation. (2004). *NWT Electricity Rates by Community*; Government of the Northwest Territories. (2004). NWT Public Utilities Board, NWT Electricity Rates, 2004.
7 Government of Nunavut,Qalliq Power Corporation. (2005). *Annual Report, 2004*.

Dispersed and Isolated Communities

In the territories, population settlement patterns and less developed transportation infrastructure affect the cost of providing public services.

Forty-three percent of Northwest Territories residents live in Yellowknife, 74 percent of Yukon residents live in Whitehorse, and 20 percent of Nunavut residents live in Iqaluit. In both the Northwest Territories and Nunavut, most people live outside of these major centres. They reside in remote, isolated communities of less than 3,500 people. On average, there is one person per square kilometre in Nunavut compared to 29 per square kilometre for Canada as a whole.[8]

Communities in Nunavut depend on air and water transportation links to southern Canada. While some of the smaller communities in the Northwest Territories are also only accessible by air or ice roads, others like Yellowknife have road access to southern Canada. Communities in Yukon are even less isolated, since all but three are accessible by road. To illustrate Nunavut's situation, it is useful to note that there are 4,681 kilometres of road in Yukon compared with one inter-community road of about 21 kilometres in Nunavut.[9]

The cost of providing public services to a dispersed and isolated population is higher than with a compact, urban population. For example, in 2003, relative to Edmonton, it cost 1.5 times more to purchase a given basket of goods and services in Iqaluit, 1.3 times more in Whitehorse and 1.2 times more in Yellowknife.[10] As illustrated in the table below, per capita spending on transportation and communications are four to six times higher in the territories than the provincial average.

Government administration costs are also higher in the territories compared with the provinces since small populations mean losses in economies of scale. For example, per capita expenditures on general government services are eight to 17 times higher in the territories than in the provinces.[11]

TABLE 3 – Selected Measures of Dispersion and Transportation Costs in the Territories, compared with the Provincial Average

	Yukon	Northwest Territories	Nunavut	Provincial Average
Population not influenced by a Census Agglomeration (percent)	25	66	80	15
Transportation/communication expenditures ($ per capita)	3,476	2,279	2,647	564
General Government expenditures ($ per capita)	2,394	2,207	4,641	270
Cost of Living Differential (Edmonton=100)	126	123	146	

Source: Finance Canada; Government of Canada, Statistics Canada, Financial Management System, Consolidated Provincial and Local Expenditures, 2003-04; Cost of Living Differential – Government of Canada, Treasury Board of Canada, Classification of Isolated Posts; Statistics Canada, Census of Canada, 2001

8 Government of Canada, Statistics Canada. (2001). *Census of Canada, 2001.*

9 Government of Nunavut. (2005). *Nunavut Economic Outlook, 2005.*

10 Ibid.

11 Government of Canada,. Statistics Canada. (2004). Statistics Canada, Financial Management System, *Consolidated Provincial and Local Expenditures, 2003-04.*

What are some indicators of expenditure needs and costs in key expenditure areas in the territories?

In considering the issue of expenditure needs in the territories, the Panel reviewed a number of indicators of expenditure needs in the territories. The following discussion explains some of these demand and cost issues in the key expenditure areas of education, health, social assistance and services, housing, and infrastructure.

Education

The percentage of people without a high school education is markedly different in both the Northwest Territories and Nunavut compared with the rest of Canada. In 2001, 25 percent of adults in the Northwest Territories and 38 percent of adults in Nunavut did not have a high school certificate, compared with 22 per cent in Canada as a whole. The situation is better in Yukon than in other parts of Canada, where only 17 percent of adults did not have a high school education. Progress is being made in education in the territories, but it is slow. For example, in Yukon, there was a seven percent reduction in the number of people with less than a high school education from 1991–2001.[12]

TABLE 4 – Comparison of Level of Educational Attainment, Population Aged 25 to 64, by Territory and Canada, 2001

	Level of Educational Attainment					
	Without high school graduation certificate	**High School**	**Trade Certificate or Diploma**	**College**	**University**	**Total**
Northwest Territories						
Number of People	4,970	3,990	3,380	3,600	3,845	**19,785**
Per cent	25.1	20.2	17.1	18.2	19.4	**100**
Nunavut						
Number of People	4,355	2,300	1,500	1,915	1,355	**11,410**
Per cent	38.2	20.2	13.1	16.8	11.9	**100**
Yukon						
Number of People	2,795	3,615	3,045	3,510	3,960	**16,925**
Per cent	16.5	21.4	18.0	20.7	23.4	**100**
Canada						
Number of People	3,698,235	3,898,405	2,097,140	2,917,895	3,676,630	**16,288,310**
Per cent	22.7	23.9	12.9	17.9	22.6	**100**

Source: Statistics Canada, 2001 Census

[12] Government of Canada, Statistics Canada. (2001). *Census of Canada, 2001.*

The percentage of adults with postsecondary education in the Northwest Territories is similar to the rest of Canada – 55 percent compared with 53 percent. Nunavut has the lowest percentage of adults with post-secondary education in Canada at 42 percent.[13]

High school graduation rates are increasing in all three territories, including among Aboriginal and Inuit students. Forty-five percent of adults in the Northwest Territories and 69 percent in Yukon have at least some high school or a high school diploma. These rates are well below the rest of Canada at 76 percent. The situation is much worse in Nunavut, where high school graduation rates are the lowest in Canada at 30 percent.[14]

A number of factors contribute to higher spending on education in the territories, including lack of economies of scale (some schools in small communities have less than 60 children), higher salaries for teachers, a higher proportion of special-needs children, and high costs of building operations.

Since there are few economies of scale in providing K-12 education in small communities, the student-to-teacher ratio is often lower than in the rest of Canada. For example, in 1999-00, there was, on average, one teacher for every 16 students in Canada, 18 students in the Northwest Territories and 12 students in the Yukon.[15]

Expenditures per student for K-12 education are higher in the territories than the Canadian average. In 2004–05, the average expenditure per student in Canada was $6,400 compared with $9,300 in the Northwest Territories, $11,427 in Yukon and $12,183 in Nunavut.[16] It is estimated that 31 percent of students in the Northwest Territories, 40 percent in Yukon and over 50 percent in Nunavut require remedial education compared with 20 percent in Manitoba and Nova Scotia.[17]

In recognition of the higher cost of living in the territories and the difficulty in recruiting and retaining qualified teachers in isolated communities, teachers' salaries are higher in the territories than in other parts of Canada. In 2003–04, with a four-year Bachelor of Education, teachers earned a maximum of $77,279 in Yukon, $81,714 in the Northwest Territories and $83,766 in Nunavut. In the same year, teachers with equivalent qualifications earned between $46,871 in Prince Edward Island and $68,967 in Alberta.[18]

In further recognition of the higher cost of living, each of the territorial governments pays a Northern Allowance to its employees, including teachers. In 2005 it varied from a low of $2,302 in Yellowknife to a high of $17,543 in Colville Lake. In Nunavut, the Northern Allowance for government employees varied from a low of $12,109 in Iqaluit to a high of $26,538 in Grise Fiord in 2005.[19]

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[13] Ibid. Government of Yukon, Department of Education. (2004). *Public Schools Branch, Annual Report 2003-04 School Year, 2004.*

[14] Ibid. Government of the Northwest Territories, Department of Education, Culture and Employment. (2004)., *Towards Excellence: A Report on Education in the NWT, November 2004.*

[15] Government of the Northwest Territories, Department of Education, Culture and Employment. (2004). *Towards Excellence: A Report on Education in the NWT, November 2004.*

[16] Ibid.

[17] Ibid.

[18] Government of Alberta, Alberta Learning. (2005). *Facts on Teachers Salaries in Alberta*. Data provided by the Government of the Northwest Territories, 2005.

[19] Data provided by Government of Nunavut, Department of Personnel, 2005.

Health

All governments in Canada have challenges delivering health care. The territories have additional challenges in part due to lower health outcomes compared with the rest of Canada. Although there has been some progress in recent years in the health status of the people in the territories, there are still significant differences with the rest of Canada. In the territories, a young population has resulted in increased demand for education-related services, health care, and social services. Demand and costs for special education and health care are higher for the young population in the territories since there are a higher proportion of special-needs children (in part due to higher rates of Fetal Alcohol Syndrome and low birth weight babies). Similarly, the higher portion of older people and Aboriginal and Inuit peoples in the territories, as compared with the rest of Canada, puts extra pressure of health care and other services in the territories.

Life expectancy is a reasonable indicator of population health status. Life expectancy for both males and females is less in the territories than for Canada; for men in Nunavut, life expectancy is ten years lower than the Canadian average.

TABLE 5 – Comparison of Selected Health Indicators in the Territories and Canada

Indicator	Northwest Territories	Nunavut	Yukon	Canada
Life expectancy at birth – males, 2002	73.2	67.2	73.9	75.4
Life expectancy at birth – females, 2002	79.6	69.6	80.3	81.2
Infant mortality rate (per 1,000 live births, 2001)	4.9	15.6	8.7	4.4
Low birth weight (% of births less than 2,500 grams)	4.7	7.6	4.7	5.5
Potential years of life lost due to unintentional injury – deaths per 1,000	1,878	2,128	1,066	628
Suicide rate (age-standardized, 3yr average)	20.8	80.2	18.5	11.5
Lung cancer mortality rate (per 100,000 population)	61	209.5	73.2	48.2

Source: Statistics Canada, Census 2001, unless otherwise noted

Infant mortality (the death of babies less than one year old) is higher in the territories than the rest of Canada, particularly in Nunavut where the infant mortality rate is over three times Canada's rate. Low birth weight is an indicator of newborn babies' general health and a determinant of infant mortality. Low birth weight babies are at a higher risk of dying during the first year of life and suffering from disabilities or challenges in learning. In Nunavut, 38 percent more infants have low birth weight compared with the rest of Canada.[20]

[20] Government of Nunavut, Department of Health and Social Services. (2005). *Nunavut Report on Comparable Health Indicators, 2004.*

The number of potential years of life lost due to unintentional injury is significantly higher in the three territories than in Canada, particularly in Nunavut where the rate is more than three times higher than Canada's.

The suicide rate in the territories is much higher than in Canada, particularly in Nunavut, where the rate is seven times higher.

Even though the population of the territories is younger, lung cancer mortality is more than four times higher than the rest of Canada. Smoking tobacco is a risk factor for many forms of cancer, heart disease, and respiratory disorders. The smoking rate for youth in the North is much higher than in Canada generally. A recent survey by Health Canada revealed that in 2004, 18 percent of Canadians aged 15-19 years smoked, compared with 43 percent in the Northwest Territories and 56 percent (of 12-19 year olds) in Nunavut.[21]

Tuberculosis is generally associated with risk factors such as overcrowded housing, smoking and chronic disease. Tuberculosis rates are higher in the territories than elsewhere in Canada. In 2000, the Canadian rate was 0.6 cases for every 100,000 people, compared with 1.9 in the Northwest Territories and 93 (based on 2002 data) in Nunavut.[22]

As illustrated above, the health status and well-being of people in the territories is much less favourable than in southern Canada, in particular in Nunavut. Due to the higher proportion of Aboriginal and Inuit people who have lower health status and a higher birth rate, there are both greater needs and demands for health care in the territories. Costs of providing health care are also higher in the territories for a number of reasons, including loss of economies of scale in providing services, lack of hospital and physician services, and higher medical transportation costs.

Health care spending is much higher per capita in the territories than in the provinces in part due to the way in which health care services are delivered. Nurses in nursing stations or small health care centres provide the majority of primary health care. In order to improve the quality and timeliness of health care services, both the Northwest Territories and Nunavut use tele-health, which may result in reductions in cost in the long run. There are limited hospital services in the territories. For example, in the Northwest Territories there are four hospitals, nine clinics and 26 health centres or nursing stations. These are distributed among 30 communities and provide a range of primary and tertiary health care services. The entire population of the territory, and the Kitikmeot region of Nunavut, is served by an acute care hospital in Yellowknife. In all but five communities, nurses and lay dispensers deliver primary health care.[23] In Nunavut, health services are delivered on a primary health care model. There is only one hospital in Iqaluit with two new health centres in Rankin Inlet and Cambridge Bay. There is a local health care centre in each of the remaining communities staffed by nurses.[24] In Yukon, there is a tertiary care hospital in Whitehorse and a hospital in Watson Lake, with health centres or nursing stations serving the rest of the population.[25]

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21 Ibid; Government of Canada, Statistics Canada and Health Canada. (2004). *Canadian Tobacco Use Monitoring Survey, 2004*. Government of the Northwest Territories, Department of Health and Social Services. (2005). *Northern Tobacco Use Monitoring Survey, 2004*.

22 Government of the Northwest Territories, Department of Health and Social Services. (2005). *NWT Health Status Report 2005, December 2005*; Government of Nunavut, Department of Health and Social Services. (2005). *Nunavut Report on Comparable Health Indicators, 2004.*

23 Data provided by the Government of the Northwest Territories, Department of Health and Social Services, 2005.

24 Information provided by the Government of Nunavut, Department of Health and Social Services, 2005.

25 Date provided by the Government of Yukon, Department of Health and Social Services, 2005.

The Canadian Institute for Health Information provides one of the few sources of comparative health expenditure data across Canada as a whole. The following table shows health care expenditure statistics for the territories and Canada. Similar to other jurisdictions in Canada, government health expenditures have been growing. Health care spending per capita is higher than the Canadian average in all three territories – 1.4 times higher in Yukon, 1.8 times higher in the Northwest Territories, and three times higher in Nunavut. Although health expenditures as a share of territorial program expenditures are lower than elsewhere in Canada, as a percent of Gross Domestic Product (GDP), they are close to four times higher in Nunavut.

Due to a combination of remoteness, dependence on air transportation, and limited hospital and physician services, each territory must pay for both in-territory and out-of-territory physician and hospital services. For example, in 2003–04, the Northwest Territories spent about $22 million on these out-of-territory services, with Alberta and British Columbia providing the majority of the services. In addition to these expenditures, the Government of the Northwest Territories spent $14 million on medical travel costs.[26] In 2004–05, Nunavut spent $22 million on out-of-territory hospital and physician services and an additional $35 million on medical travel costs.[27] In 2004–05, Yukon spent $10 million on out-of-territory hospital and physician services and $5 million on medical travel, significantly less than the other two territories.[28]

TABLE 6 – Comparison of Various Health Expenditure Statistics, Territories and Canada, 2003 to 2005

$ millions and per cent

	Canada			Northwest Territories			Nunavut			Yukon		
	2003	2004f	2005f	2003	2004f	2005f	2003	2004f	2005f	2003	2004f	2005f
Government Health Expenditures	78,500	83,748	89,814	202	211	212	235	233	252	104	115	124
Health Expenditures (Per Capita)	2,479	2,622	2,790	4,780	4,921	4,916	8,060	7,883	8,375	3,394	3,699	3,955
Health Expenditures (Per cent of Program Expenditures)	38	39	39	19	18	18	27	35	31	18	17	16
Health Expenditures (Per cent of Gross Domestic Product)	6.4	6.5	6.6	5.6	5.0	4.6	24.7	22.8	22.5	7.8	8.1	7.9

Source: Canadian Institute for Health Information, National Health Expenditure Trends, 1975 to 2005, *December 2005*
Note: 2004 and 2005 are forecasts

[26] Data provided by the Government of the Northwest Territories, Department of Health and Social Services, 2005; Government of the Northwest Territories, Department of Finance. (2005). *Budget and Main Estimates, 2005–06*.
[27] Data provided by the Government of Nunavut, Department of Health and Social Services, 2005.
[28] Data provided by the Government of Yukon, Department of Health and Social Services and Department of Finance, 2005.

Social Assistance and Services

High participation rates in the labour force have resulted in high average family incomes, except for Nunavut where the average family income is 20 percent lower than the Canadian average. The unemployment rate in Nunavut is also more than double Canada's.

Compared with the Canadian average, rates of violent crime are four times greater in Yukon, seven times greater in the Northwest Territories, and eight times greater in Nunavut. Rates of property crime are about 1.8 times higher in the territories than in the rest of Canada.

TABLE 7 – Comparison of Selected Indicators of Social Well-Being in the Territories and Canada

Indicator	Northwest Territories	Nunavut	Yukon	Canada
Percentage of single parent families	21	26	20	16
Average family income	$75,102	$52,624	$69,564	$66,160
Labour force participation rate	75.9	68.1	76.0	66.9
Unemployment rate (2001-02)	5.8	17.4	9.4	7.4
Crimes of violence (per 100,000 people, 2003)	6,792	7,943	3,799	963
Property crimes (per 100,000 people, 2003)	7,220	7,221	7,421	4,121

Source: Statistics Canada, Census 2001, unless otherwise noted

Social service caseloads are higher in the territories due to high unemployment in small communities. Territorial governments provide most income support since most people are either unemployed on a long-term basis or participate in the non-traditional economy making them ineligible for federally funded Employment Insurance benefits. In 2005, close to 2,000 people (just over four percent of the population in the Northwest Territories) accessed income support at a cost of $7.2 million to the territorial government (2003–04 data).[29] In 2004, about 5,000 (60 percent) households in Nunavut received some form of income support.[30] In Yukon, close to four percent of people received social assistance in 2004, costing about $9 million.[31]

[29] Data provided by the Government of the Northwest Territories, Department of Health and Social Services, 2005; Government of the Northwest Territories, Department of Finance. (2004). *Main Estimates, 2004-05*.
[30] Data provided by the Government of Nunavut, Department of Health and Social Services, 2005.
[31] Data provided by the Government of Yukon, Department of Health and Social Services, 2005.

Housing

It is widely recognized that adequate housing improves school performance, health status, and social well-being.

In the Northwest Territories and Nunavut, housing is the most overcrowded in Canada. There are, on average, 2.4 persons per dwelling in Canada compared with 2.1 in Yukon, 2.9 in the Northwest Territories and 3.3 in Nunavut. Overcrowding is particularly evident in Nunavut, where more than four people per dwelling in 52 percent of dwellings and more than five people per dwelling in 32 percent of dwellings.[32]

In 2001, 34 percent of the housing stock in Canada required major or minor repairs compared with 43 percent in Yukon, and 48 percent in the Northwest Territories and Nunavut.[33]

There is a significant shortage of housing units in the territories, particularly in Nunavut. In 2001, the shortfall was estimated at 1,830 units in Yukon, 2,220 units in the Northwest Territories and 2,735 units in Nunavut.[34] The situation has not improved significantly since then. The Nunavut Housing Corporation estimates that population growth will create a need for an additional 273 housing units every year over the next ten years and to bring the number of occupants per dwelling to the Canadian average.[35] About 54 percent of the population in Nunavut lives in public or government housing, compared with 23 percent in the Northwest Territories and six percent in the rest of Canada.[36]

The costs of public housing construction, repair, and maintenance are much higher in the territories than in southern Canada due to the cost of shipping, labour, and land development and climate. For example, in 2004, it cost $330 per square foot to construct a new home in Nunavut, $19,800 for annual repair and maintenance, and $11,370 for annual utility costs. The cost of housing construction varies considerably within the territories, depending in large part on access to transportation routes. In 2004, in the Northwest Territories, the cost of constructing public housing varied from $132 per square foot in Kakisa, to $244 in Inuvik and $219 in Yellowknife. These compare to an average cost of $103 per square foot in southern Canada.[37]

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[32] Government of Nunavut, Nunavut Housing Corporation (2005). *Business Plan, 2005–06*, p. 11.
[33] Government of Canada, Statistics Canada. (2001). *Census of Canada*, 2001; Government of the Northwest Territories, Northwest Territories Bureau of Statistics, 2004.
[34] Government of Canada, Canada Mortgage and Housing Corporation. (2001). *Canadian Housing Observer, 2001*; Government of Canada, Statistics Canada. (2001). *Census of Canada, 2001*.
[35] Government of Nunavut, Nunavut Housing Corporation and Nunavut Tunngavik Incorporated. (2004). *Nunavut Ten-Year Inuit Housing Action Plan, September 2004.*
[36] Government of Nunavut, Nunavut Housing Corporation. (2005). *Business Plan, 2005–06*, p.15.
[37] Government of the Northwest Territories, Northwest Territories Housing Corporation. (2005). *2005-2008 Business Plan*. Data provided by the Northwest Territories Housing Corporation, 2005.

Infrastructure

Similar to other jurisdictions in Canada, the existing infrastructure in the territories is aging and in need of repair (transportation, hospitals, schools, bridges). Over the next five years, the capital investment needed to address this problem is estimated at $485 million for Yukon, $650 million for Nunavut, and $636 million for the Northwest Territories.[38] The largest infrastructure needs are in highways, schools, social housing, and airports.[39] Territorial government expenditures are expected to grow faster in justice, transportation and health and social services.

The Northwest Territories also faces significant expenditure pressures due to the impact of resource development. These expenditure pressures can be categorized into forced growth (incremental costs related to maintaining existing service levels) and strategic impacts (investments required to maximize benefits or mitigate negative impacts from development). Over the period 2005–06 to 2014–15, the Government of the Northwest Territories estimates that forced growth from resource development will increase expenditures by $351-$475 million (depending on the inflation assumption).[40]

The Panel's assessment

There is significant evidence that the two components of expenditure need (workload and costs) are higher in the three territories compared with Canadian averages. TFF grants to the territories are already substantially higher per capita than Equalization payments to receiving provinces in recognition that expenditure needs are much higher in the territories compared with the provinces. However, after reviewing data on expenditure need and indicators of health and social well-being in the territories, the Panel believes that there is sufficient evidence to warrant an increase in TFF funding through a rebasing to 2005–06 funding levels contained in the New Framework. In addition, to maintain some comparability in the future, the Panel recommends a return to the PAGE escalators for TFF funding, which, in its view, more appropriately reflects changes in territorial expenditure needs than a fixed growth rate.

Since there are significant data and conceptual challenges in estimating expenditure need, a comprehensive study of expenditure need in the territories was beyond the ability of the Panel to complete during the time available. The Panel believes that a study of expenditure need and the cost of providing services in the territories may be useful to indicate whether or not the TFF program is achieving its objectives in the longer term, but it would be complex, costly and time-consuming. Identifying workload and cost factors and differentiat-

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[38] The estimate of infrastructure needs in the Northwest Territories is for the next five years, as part of the Government of the Northwest Territories' 20-year Capital Needs Assessment. Government of the Northwest Territories. (2003). *Opportunities for Infrastructure Partnerships, Discussion Paper*, RT Associates Ltd., June 2003; Government of the Northwest Territories, Department of Transportation. (2005). *Corridors for Canada II: Building on Our Success*, September 2005. Yukon data provided by the Government of Yukon, Financial Management Board and Department of Finance, Capital Planning, February 2006; Nunavut data provided by the Government of Nunavut and Nunavut Association of Municipalities, 2005.

[39] Government of the Northwest Territories. (2003). *Opportunities for Infrastructure Partnerships, Discussion Paper*, RT Associate Ltd., June 2003; Government of the Northwest Territories, Department of Transportation. (2005). *Corridors for Canada II: Building on Our Success*, September 2005.

[40] Government of the Northwest Territories. (2006). *Resource Development Impacts, January 2006*. Inflation assumptions range from 1 to 2 percent.

ing between them poses a number of methodological challenges. In practice, assessing the weights to be assigned to these factors and isolating them from policy choices requires considerable judgement. The Panel therefore recommends that an extensive and detailed study of expenditure needs in the territories may not be useful at this time. Furthermore, the Panel suggests that the federal government's assessment of TFF funding levels in future may include a review of the progress on a number of indicators of health and social well-being and comparisons of expenditure needs in key territorial expenditure areas.

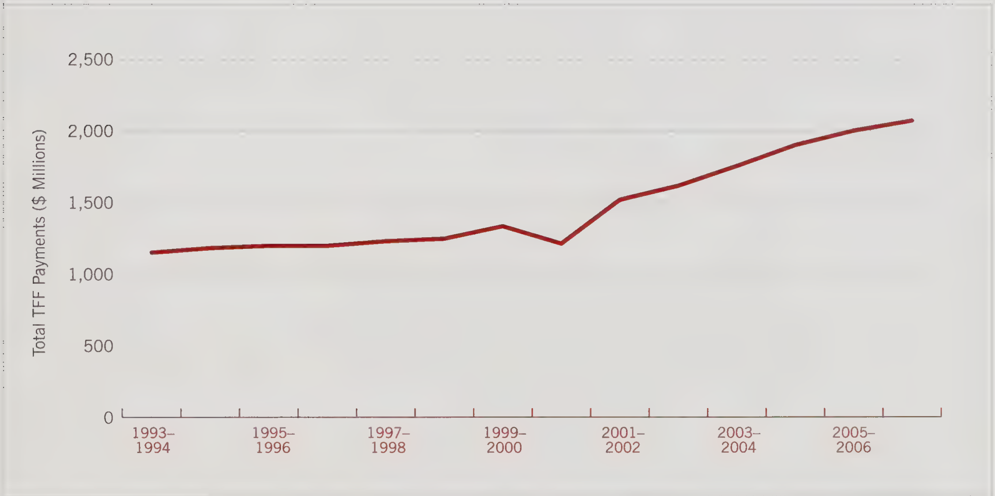
In the Panel's opinion, the situation in Nunavut is substantially different. In its view, an adjustment to the TFF funding base and ongoing escalation of TFF are not sufficient to address specific gaps in programs, services, and infrastructure in Nunavut. The immediate objective of a study to address these challenges should be to identify particular areas of need and to provide additional funding where required, through targeted programs rather than through adjustments to TFF. In this way, the federal and territorial governments can ensure that funding is provided to assist in resolving problems in specific expenditure areas and that appropriate financial accountabilities are in place for these additional funds. The Panel recommends that further work be done to assess expenditure needs in Nunavut as a starting point for addressing those needs on an urgent basis.

Annex 3: Territorial Formula Financing: A Brief History

Territorial Formula Financing (TFF) is the main federal transfer to the territorial governments. It was established in 1985 to provide territorial governments with annual unconditional transfers from the federal government. This allowed territorial governments to offer their residents levels of public programs and services that are reasonably comparable to those available to other Canadians, at reasonably comparable levels of taxation, taking into account the higher cost of providing services in the territories and the territories' more limited ability to raise revenue.

As illustrated in Figure 1, TFF grants to the territories are expected to be $2.07 billion in 2006–07. This amounts to between $16,274 and $27,396 per capita depending on the territory in question (see Figure 2). By way of comparison, in 2006–07, the highest per capita Equalization payment to any provincial government is expected to be $2,022 to Prince Edward Island in 2006–07.[1]

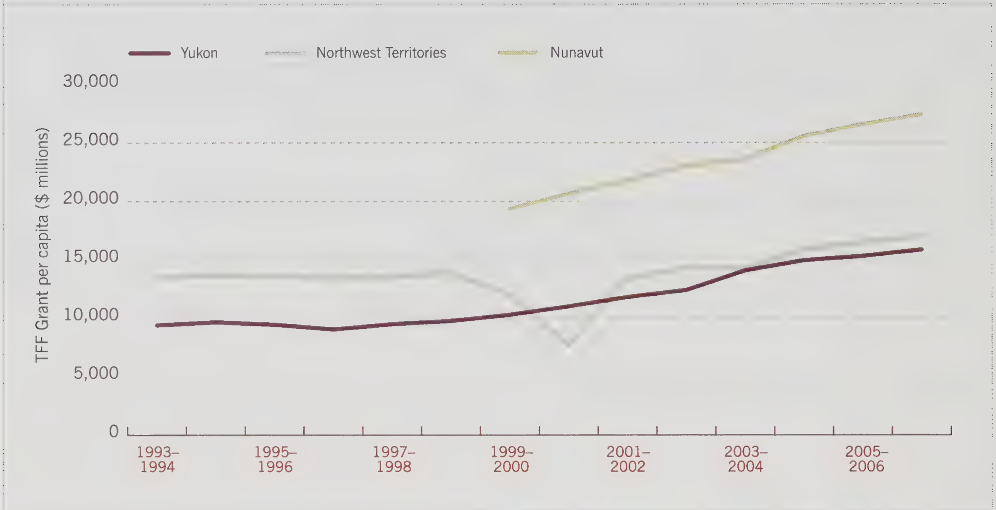
FIGURE 1 – Total TFF Payments:1993-94 to 2006–07



Source: Finance Canada, 2006–07 Territorial Formula Financing entitlements announced by the federal Minister of Finance in November 2005 with calculations based on October 2005 data.

[1] 2006–07 Equalization entitlements announced by the federal Minister of Finance in November 2005 with calculations based on October 2005 data.

FIGURE 2 – TFF Grants by Territory, 1993-94 to 2005–06



Source: Finance Canada; 2006–07 Territorial Formula Financing entitlements announced by the federal Minister of Finance in November 2005 with calculations based on October 2005 data.

In 2005–06, TFF accounted for over 60 percent of Yukon's and Northwest Territories' budgetary revenues, and 81 percent of Nunavut's.[2]

Before TFF was introduced in 1985, the federal government transferred funds to territorial governments, but not according to a formula. The Department of Indian Affairs and Northern Development financed territories on a program-by-program basis (e.g., education, infrastructure, housing, etc.). Territorial governments required federal approval for their spending decisions and could not be held clearly accountable by territorial residents for their spending decisions.

1985 to 2004

This method of funding for territorial governments (Yukon and the Northwest Territories) was replaced in 1985 by a gap-filling formula approach under the new Territorial Formula Financing arrangements. Under this new approach, each territorial government received an annual TFF grant (i.e., a single, large unconditional cash transfer) from the federal government, which it could allocate and spend according to its own priorities. From then on, territorial governments were held accountable to territorial voters for their policy choices and budgetary management, not to the federal government.

[2] Calculations based on 2005–06 Revised Estimates contained in the 2006–07 budgets for each territory.

From 1985 to 2004, the TFF grant was governed by agreements between each territorial government and the federal government. These agreements were for a limited term, generally five years, and were renegotiated or renewed for the subsequent funding period. Although there were changes to the formula in each renewal, the basic structure of TFF remained intact until October 2004 when the New Framework was introduced.

Each year the amount of a territory's grant was determined by a formula that:

- Proxied the value of how much a territorial government would need to spend in order to provide levels of public services that are reasonably comparable to those provided by provincial governments. This expenditure need proxy was referred to as the Gross Expenditure Base (GEB).
- Measured the territorial government's ability to generate revenues from its own sources at taxation levels that are reasonably comparable to those set by provinces. These included not only the taxes and fees a territory could impose but also some of the other transfer payments received from the federal government. This measure was called Eligible Revenues.
- Computed a grant amount equal to the difference between the GEB, a proxy of expenditure needs and Eligible Revenues (see Box 1).

BOX 1 — TFF FORMULA – FILLING THE GAP

TFF Grant = Gross Expenditure Base (GEB) – Eligible Revenues

Gross Expenditure Base (GEB)

The GEB did not measure what a territorial government actually spent in a particular year. Rather, it sought to approximate the total fiscal capacity required in order to provide territorial residents with levels of public programs and services that were "reasonably comparable" to those provided by provinces. Separating the formula's GEB (and therefore, the size of the TFF grant) from actual territorial spending was deliberate; territorial governments could not increase the size of their grant by spending more money. Similarly, their grant was not reduced if they reduced their actual spending. The same principle applies to Equalization, which measures the potential, not actual revenues raised by provinces.

A benchmark GEB value was based on territorial revenues of each territory in 1982–83. At that time, the GEB was considered adequate to meet expenditure requirements by the territories. This amount was considerably higher than the spending by provinces, reflecting the higher costs and unique circumstances of providing "reasonably comparable" programs and services in the territories.

This benchmark GEB was escalated annually to reflect the growth of government expenditures over time. The escalator assumed that, to ensure ongoing comparability, territorial government spending should keep pace with that of provincial and local governments providing corresponding programs and services "south of 60". Starting in 1990, the formula's GEB escalator also took into account the change in each territory's population growth relative to that of Canada as a whole.

BOX 2 — GEB ESCALATOR – SIMPLIFIED EXAMPLE

In computing the 2001–02 GEB for Yukon, the previous year's GEB of $374 million was,

- **increased by 5.06 percent in response to the three-year average of annual growth in Canada's provincial/local government spending. This raised the GEB to $393 million.**
- **The GEB was then reduced by 2.0 percent to reflect Yukon's average annual population decline relative to Canada's population growth from 1999 to 2002.**

This resulted in a 2001–02 GEB for Yukon of $385 million. ($374 million times 1.0506 times (1-0.02) = $385 million)

This basic GEB, described in Box 2, was subject to other adjustments.

It was raised each time the territories assumed new responsibilities from the Department of Indian and Northern Affairs (program transfers) or other federal programs (e.g., Labour Market Development Agreements).

- Technical adjustments were made to the GEB to ensure that grant amounts would not be unintentionally affected. For example, in the 1995 Renewal, an Economic Development Incentive (EDI) was introduced into the revenue side of the formula (as described below) and a consequential change was required in the GEB.
- The federal government reduced each territory's 1996-97 GEB by five percent in its 1995 budget as part of overall federal budgetary restraint measures taken at that time.
- When Nunavut was established in 1999, the GEB of the former Northwest Territories was split between Nunavut and the post-division Northwest Territories based on the Historical Expenditure Ratio (HER) of 46 percent Nunavut and 54 percent Northwest Territories. The combined GEB was also raised at that time to take into account the diseconomies of scale involved in running two governments rather than one.

Eligible Revenues

Territorial governments have two types of revenues in addition to TFF: other transfer payments from the federal government and own-source revenues that they generate themselves. Both of these are considered in the Eligible Revenues component of the TFF formula.

While, the main transfer payment for territories is the TFF grant itself, territories also receive the Canada Health Transfer (CHT) and the Canada Social Transfer (CST). There are various other, smaller federal transfers, some of which were included as Eligible Revenues for TFF purposes. The majority of these smaller transfers, however, were not included as Eligible Revenues for the territories and therefore did not have an impact on the size of the TFF grant.

Revenues the territories generate themselves, own-source revenues, come in a variety of forms such as taxes, fees charged for permits issued or services provided and earnings on investments. While transfer payments entered the formula's Eligible Revenues as the amounts the territories actually received, this was not the case for most own-source revenues. The majority of own-source revenues entering into the formula were measured as *potential* amounts a territorial government could collect if it exerted a reasonable tax effort. This amount was called a territory's "Hypothetical Own-Source Revenues".

This means that territorial governments could not increase the size of their grant by reducing their tax levels. Similarly, if territorial governments decided to increase their actual tax levels, their TFF grant was not reduced.

BOX 3 — ELIGIBLE REVENUES

Eligible Revenues = Transfer Payments + Hypothetical Own-Source Revenues

The formula measured potential Hypothetical Own-Source Revenues in the following manner:

- Calculate what actual revenues would have been if a territorial government had not adjusted tax rates since a particular base year (1992-93 in recent versions of the formula).
- Compute what revenues (at 1992–93 rates) would have been had the territory exerted a reasonable tax effort in that year. This was referred to in the formula as the Catch-Up Factor (CUF).
    - Part of this calculation required adjusting the tax effort measurement to recognize that territorial governments cannot be expected to make the same tax effort as provincial governments due to higher costs in the territories. For this reason, a 15 percent Northern Discount Factor was applied to the National Average Tax Rate to determine a reasonable territorial tax effort.
- Escalate 1992–93 'caught up' revenues in line with how much provinces increased their tax effort over this period. Territories are expected in the formula to increase tax effort at the same pace to keep it reasonable. This adjustment is referred to as the Keep-Up Factor (KUF).
- The cumulative effects of multiplying the CUF, KUF, and the 15 percent Northern Discount Factor were known together as the Tax Effort Adjustment Factor (TEAF). The impacts of the TEAF led to the introduction of further adjustments as described below.

Some own-source revenues (e.g., court fines and interest revenues) were not wholly under the control of territorial governments and therefore were not subject to the actual-to-potential adjustment. For these revenue sources, actual revenues were included directly in the calculation of eligible revenues. A few revenue sources were excluded entirely from Eligible Revenues, including those introduced since the establishment of TFF in 1985, in order to encourage territorial governments to increase their own-source revenues. It also allowed territorial governments to benefit from new federal transfer programs without having them offset by reductions in the TFF grant.

Natural resource revenues deserve special mention. Constitutionally, authority for the administration and control of onshore territorial natural resources rests with the federal government, including the right to impose taxes and royalties. The Government of Canada is in the process of devolving these responsibilities as part of general policy supporting the political and economic development of the territories. This process is complete in Yukon, underway in the Northwest Territories, and the Government of Canada is committed to initiating similar discussions in Nunavut.

Following Yukon devolution, natural resource revenues collected by the territory are not included in TFF Eligible Revenues. Rather a separate revenue-sharing process determines how much resource revenues the territorial government retains after a separate offset against the TFF grant.

Additional TFF Features

Other intricacies introduced into the TFF formula over the years, prior to the introduction of the New Framework in October 2004, are briefly discussed below.

Ceiling – In 1988, a Gross Domestic Product (GDP) ceiling was added to the formula. The ceiling placed an upper limit on the annual growth of the Provincial-Local Government Expenditure Factor (P-L) in the Population-Adjusted Gross Expenditure Escalator (PAGE) escalator. The ceiling was calculated as the three-year moving average of Canadian nominal GDP growth. If the P-L growth rate exceeded the ceiling in a particular year, the lower GDP ceiling value was substituted into the calculation of the annual PAGE escalator. The resulting ceiling-lowered GEB would then become the starting point for calculating the following year's GEB. In this way, if the ceiling applied in one year, the GEB and the TFF grant would be permanently reduced. This path-altering aspect of the ceiling was modified in the 1999 renewal and was eliminated effective 2002–03.

1995 budget cuts – The federal government announced two changes to the formula in the 1995 budget. First, the 1995–96 grants were frozen at the 1994–95 level. Second, the 1996–97 GEB was cut by five percent for each territory. The first change was a one time only action and did not affect the GEB or the TFF grant in subsequent years. The second change altered the GEB in 1996–97 and had an on-going effect.

Canada Health and Social Transfer (CHST)/CHT/CST enrichments – Starting with the 1999 federal budget, the Canada Health and Canada Social Transfers were increased. Normally this would not have financially benefited the territories since these transfers would have been included in Eligible Revenues and decreased TFF grant by exactly the same amount. However, it was agreed that the territories should share in the extra funding. Therefore, the definition of Eligible Revenues was modified to exclude the CHST/CHT/CST increases for 1999–2000 and following years.

Economic Development Incentive (EDI) – As part of the 1995 renewal, an EDI was added to the formula (see Box 4). The EDI was an adjustment to reduce the amount of Hypothetical Own-Source Revenues by 20 percent before the TFF grant was calculated. The EDI was forward-looking and not intended to provide an increase to the territories' 1999–2000 TFF grants. Therefore, that year's GEB was reduced by the same amount as Eligible Revenues, in order to make the implementation of the EDI revenue neutral in the first year (1999–2000).

Floor – In the 1999 renewal, a floor was added to the formula, to come into effect in years when provincial and local government expenditures fell by more than one percent from the previous year. The floor limited the resulting decline in the GEBs to one percent.

The last scheduled five-year renewal exercise took place in 2004. In the lead up to the renewal, an agreement was reached on a number of technical modifications to the TFF formula including the removal of the ceiling, as well as an increase in the GEBs of the three territories.

This renewal package was still being finalized in April 2004. TFF payments continued based on the 1999–2004 agreements and were to have been subsequently revised retroactively. As it happened, the New Framework announced in October 2004 superseded the April 2004 agreement, which was never finalized.

BOX 4 — ECONOMIC DEVELOPMENT AND "PERVERSITY" OF TFF FORMULA

The TFF's complex actual-to-potential-revenue adjustment had a number of outcomes. The most noteworthy was when a territory raised an extra dollar in actual revenue, the formula credited it with more than an extra dollar in potential revenue. (This greater-than-dollar-for-dollar effect reflected the particular TEAF value exhibited by the territories. With a lower TEAF the formula would have assessed less than a dollar in potential revenue.)

The territories drew attention to an issue implicit in this greater-than-dollar-for-dollar offset. They argued that, when their economies grew and their own-source revenues increased, their TFF grant would fall by even more. In that way, the formula caused economic development to impose a financial penalty on the territorial governments rather than give them a reward. Territories described this as a "perversity" of the formula.

The federal government pointed out that this result was the consequence of the territories putting forth a tax effort of less than 85 percent of the provincial average. If territorial tax effort exceeded the 85 percent standard, an extra dollar in actual revenue would result in less than a dollar's reduction in the TFF grant.

An economic development incentive, the EDI was added to the TFF formula as part of the 1995 renewal. This mechanism removed 20 percent of Hypothetical Own-Source Revenues from the grant calculation. The EDI meant that there would be no "perversity" unless territorial tax effort was less than 68 percent of the provincial average (i.e., the 85 percent Northern Discount Factor multiplied by the 80 percent EDI).

The New Framework

At the First Ministers' Meeting in October 2004 the federal government announced a New Framework for Equalization and TFF. It set out a ten-year growth track for TFF and suspended its allocation formula, pending a review by the Expert Panel on Equalization and Territorial Formula Financing. The New Framework was legislated on March 10, 2005. More specifically:

- The normal workings of TFF, including the April 2004 renewal modifications, were put on hold. The formula parameters (i.e., GEB, Eligible Revenues, PAGE escalator, CHST/CST/CHT offsets and EDI) would not play a role in determining the TFF payments to territorial governments while the allocation formula was reviewed.

- The total TFF envelope for all three territories was set at $1.9 billion for 2004–05 and $2.0 billion for 2005–06. Thereafter, the total TFF pool would grow by 3.5 percent annually, with a review in 2009–10.

- For 2004–05 and 2005–06, grants would no longer be determined by three separate formulas in accordance with TFF agreements. Instead, the three territories received shares of the $1.9 billion in 2004–05 and the $2.0 billion in 2005–06 based on three-year moving averages. Territorial shares were determined by the relative sizes of the grants each territory received in 2002–03, 2003–04, and 2004–05, with the greatest weight placed on the most recent year.

- In November 2005, the federal Minister of Finance announced that for 2006–07 the allocation of the $2.07 billion would be based on the same methodology used to allocate 2004–05 and 2005–06, using the most recent data.

- Under the New Framework, TFF grants are now being determined in accordance with federal legislation, not on the basis of TFF agreements between the federal government and each of the territories.

Annex 4: A New Approach to Territorial Formula Financing (TFF)

Each year the territories receive funding through Territorial Formula Financing (TFF). The Panel was asked to provide advice on how this funding should be allocated amongst the territories, taking into consideration:

- the current Gross Expenditure Base (GEB) approach;
- the treatment of various territorial revenue sources, such as natural resources;
- the measurement of territorial tax effort;
- other approaches to measuring fiscal capacity, including those based on macroeconomic variables; and
- if appropriate, alternative indicators of expenditure needs.

This annex outlines the key changes to TFF proposed by the Panel, explains the methodology used to examine financial impacts, makes a number of comparisons and forecasts, and concludes with a discussion of stability and predictability.

The Panel's proposed changes to TFF

The Panel recommends returning to a gap-filling formula to calculate TFF entitlements, determined separately for each territory, as follows:

TFF Grant = New Operating Base multiplied by PAGE escalator minus Revenue Block

New Operating Base

The New Operating Base portion of the formula is determined by two components, the Operating Base multiplied by the annual Population-Adjusted Gross Expenditure Escalator (PAGE).

The New Operating Base does not measure what a territorial government actually spends in a particular year. Rather, it is a proxy for the total fiscal capacity required to provide levels of public programs and services to territorial residents that are reasonably comparable to those provided by the provinces.

The Panel recommends that a New Operating Base be established, beginning in 2005–06. It would be equal to the sum of the TFF grant under the New Framework plus the value of the Revenue Block in that same year. To obtain the amount of the New Operating Base in 2006–07, the 2005–06 New Operating Base of each territory would be multiplied by the 2006–07 PAGE escalator.

PAGE Escalator

The initial New Operating Base should be adjusted annually for each territory based on the relative growth in population and provincial-local spending. This is the PAGE escalator used in the previous TFF formula. To ensure that it is responsive to changing circumstances in each of the territories, including population changes, the Panel recommends that the data used in the calculation of the PAGE escalator remain open for three years.

Revenue Block

In the previous TFF formula, the measure of eligible revenue capacity was comprised of a number of factors, including a Tax Effort Adjustment Factor (TEAF-composed of a Catch-Up Factor that measured territorial tax effort in 1992–93, a separate Keep-up Factor that updated the effect of the Catch-Up Factor each year, and a constant Northern Discount Factor) and a 20 percent Economic Development Incentive (EDI). The Panel's measure of revenue capacity applies the National Average Tax Rate approach to measuring the value of seven revenue bases each year, with an inclusion rate of 70 percent.

Methodology used to calculate the financial impact of the Panel's approach

The Panel chose to present the financial impact of its approach over the regular five-year renewal period, from 2005–06 to 2009–10. The financial impact of the Panel's approach for each territory is compared with the TFF entitlements the territories received under the New Framework, and with the previous TFF formula.

The starting New Operating Base for each territory in the base year 2005–06 is the total of the 2005–06 TFF grant under the New Framework and estimated territorial revenues in that year using the Panel's approach. Thereafter, the New Operating Base for each territory is adjusted annually based on the relative growth in the population of each territory compared to Canada, and growth in provincial and local spending as measured by the PAGE escalator. The estimates of the PAGE escalator for each territory were provided by Finance Canada based on Conference Board of Canada data.

To calculate the Revenue Block for each territory, seven revenue bases were estimated using the federal Representative Tax System (RTS). The sum of the seven revenue bases was then reduced by 30 percent to reflect the 70 percent inclusion rate recommended by the Panel.

Under the Panel's approach, the revenues included in the formula would be less than the eligible revenues under the previous TFF formula, even after all of the adjustments to territorial revenues under the previous TFF formula have been made. For example, in 2005–06 the Revenue Block for the Northwest Territories would have been $152 million, compared with eligible revenues of $181 million under the previous TFF formula. The difference is due to a number of factors, including the change to the RTS measurement of revenues, the Panel's revenue offset of 30 percent, and the exclusion of other federal transfers.

The financial impact of the Panel's approach is also compared to TFF entitlements under the previous TFF formula. Estimates of TFF entitlements under the previous TFF formula were provided by Finance Canada.

Comparison of the Panel's approach with the New Framework and the previous TFF formula

The financial impact of the Panel's proposed approach was based on information available as of February 2006 and information from the joint territorial submission. The overall cost of TFF, and entitlements for each territory, will vary as more up-to-date data become available and as the economies and population of the territories change relative to Canada over time. For these reasons, the financial impact of the Panel's recommendations, as depicted in this annex, should be considered as illustrative of potential financial impacts.

The Panel's approach provides more funding to the territories than either the legislated New Framework or the previous TFF formula. This is because of the combined effect of the upward adjustment to the GEB for each territory, the reintroduction of the Population Adjusted Gross Expenditure Escalator (PAGE), and the 70 percent inclusion rate for territorial revenues.

The Panel's approach compared with the New Framework: 2007–08

Table 1 compares total TFF funding under the Panel's proposed approach to what the territories would receive under the New Framework, from 2005–06 to 2007–08. Under the New Framework, total funding to the territories would be \$2.14 billion in 2007–08. In that year, the Panel's approach would provide an additional \$60 million for the territories.

TABLE 1 – Comparison of the Panel's Approach with the New Framework, 2005–06 to 2007–08

		$ million	
	2005–06	**2006–07**	**2007–08**
Panel's Approach	2,000	2,098	2,203
New Framework	2,000	2,070	2,143
Difference	0	28	60

The Panel's approach compared with TFF formula: 2007–08

Table 2 shows that in 2007–08, the territories would receive an additional $123 million in funding under the Panel's approach, compared with the previous TFF formula. The Northwest Territories would receive an additional $40 million, Nunavut an additional $48 million and Yukon an additional $35 million. On a per capita basis, that translates into a gain of $918 for the Northwest Territories, $1,591 for Nunavut and $1,126 for Yukon in 2007–08.

TABLE 2 – Comparison of the Panel's Approach with TFF Formula for 2007–08

	$ million / $ per capita			
	Northwest Territories	**Nunavut**	**Yukon**	**Total TFF**
Panel's Approach for 2007–08				
Total Entitlements	791	880	532	**2,203**
Per Capita Entitlements	18,148	29,165	17,114	
TFF Formula for 2007–08				
Total Entitlements	751	832	497	**2,080**
Per Capita Entitlements	17,231	27,574	15,988	
Difference				
Total Entitlements	***40***	***48***	***35***	***123***
Per Capita Entitlements	***918***	***1,591***	***1,126***	

Note: Totals may not add since figures have been rounded up to the nearest million.

The Panel's approach compared with announced entitlements: 2006–07

Table 3 shows that the territories would receive $133 million in additional funding under the Panel's proposed approach in 2007–08 compared with 2006–07 entitlements announced in November 2005. The Northwest Territories would receive an additional $53 million, Nunavut an additional $53 million and Yukon an additional $26 million. On a per capita basis, that translates into a gain of $1,041 for the Northwest Territories, $1,548 for Nunavut and $779 for Yukon in 2007–08.

TABLE 3 – Comparison of the Panel's Approach for 2007–08 with the New Framework, Announced Entitlements for 2006–07 by Territory

	$ million / $ per capita		
	Northwest Territories	**Nunavut**	**Yukon**
Panel's Approach for 2007–08			
Total Entitlements	791	880	532
Per Capita Entitlements	18,148	29,165	17,114
Announced Entitlements for 2006–07			
Total Entitlements	738	827	506
Per Capita Entitlements	17,107	27,617	16,335
Difference			
Total Entitlements	***53***	***53***	***26***
Per Capita Entitlements	***1,041***	***1,548***	***779***

Note: TFF entitlements for 2006–07 were announced by the federal Minister of Finance in November 2005, based on October 2005 data. Totals may not add since figures have been rounded up to the nearest million.

The Panel's approach compared with the New Framework: 2005–06 to 2009–10

Table 4 shows that over a five-year period, from 2005–06 to 2009–10, the Panel's approach would provide $285 million more to the territories than the New Framework. Under the Panel's approach, TFF entitlements would increase by 20 percent over this period, compared to 15 percent under the New Framework.

TABLE 4 – Comparison of the Panel's Approach with the New Framework, 2005–06 to 2009–10

	$ million					
	2005–06	**2006–07**	**2007–08**	**2008–09**	**2009–10**	**Total**
Panel's Approach	2,000	2,098	2,203	2,304	2,406	**11,011**
New Framework	2,000	2,070	2,143	2,218	2,295	**10,726**
Difference	0	28	60	86	111	**285**

The Panel's approach compared with TFF formula: 2005–06 to 2009–10

Table 5 shows that from 2005–06 to 2009–10 the Panel's approach would provide $549 million more to the territories than the previous TFF formula. The Panel's recommendations would increase TFF funding by four percent per year, in line with increases under the previous TFF formula.

TABLE 5 – Comparison of the Panel's Approach with TFF Formula, 2005–06 to 2009–10

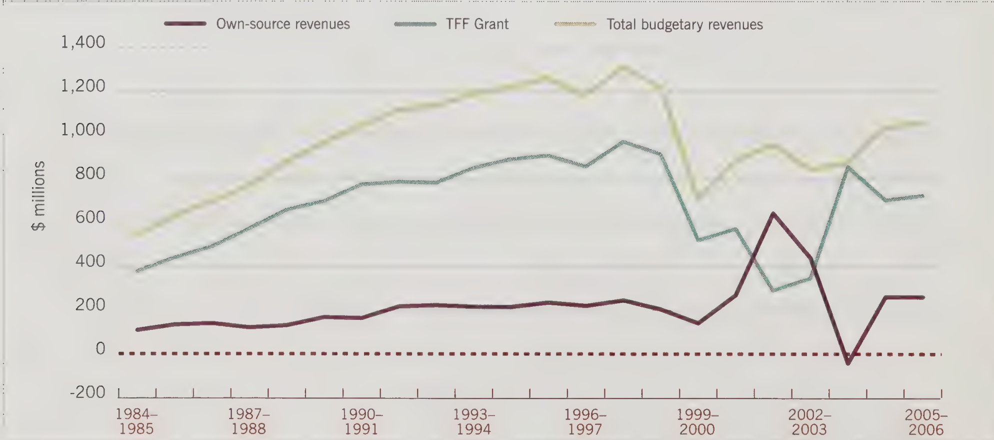
	$ million					
	2005–06	**2006–07**	**2007–08**	**2008–09**	**2009–10**	**Total**
Panel's Approach	2,000	2,098	2,203	2,304	2,406	**11,011**
TFF Formula	1,901	2,010	2,080	2,183	2,288	**10,462**
Difference	99	88	123	121	118	**549**

Stability and predictability

The Panel's mandate calls for recommendations on how to improve the predictability and stability of TFF. Although the Joint Territorial Submission identified adequacy as the key issue, it is also important to reduce the volatility of entitlements and improve the ability of territories to predict those entitlements because they comprise the majority of territorial budgetary revenues. For example, in 2005–06, the TFF grant was between 64 and 81 percent of territorial revenues.

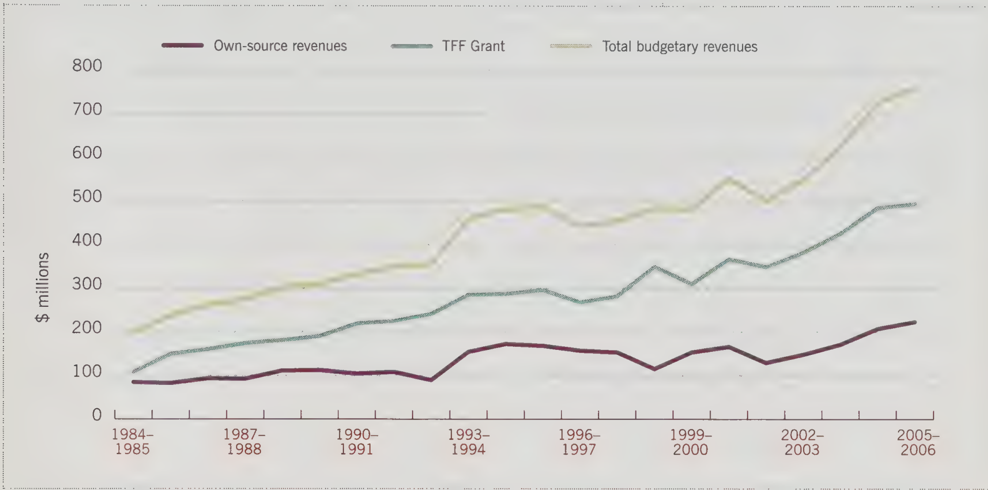
Stability and predictability have been particularly important recently to the Northwest Territories. As the following charts illustrate, total revenues have been more variable in this territory than in either Nunavut or Yukon.

FIGURE 1 – Trends in Revenue Sources for the Northwest Territories, 1984–85 to 2005–06



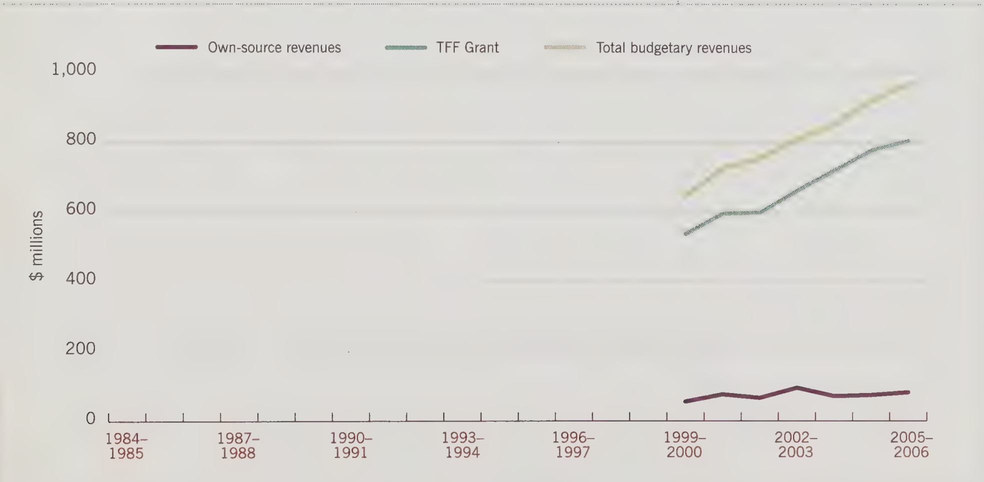
Source: Government of Canada, Statistics Canada, Financial Management System, 2005

FIGURE 2 – Trends in Revenue Sources for Yukon, 1984–85 to 2005–06



Source: Government of Canada, Statistics Canada, Financial Management System, 2005

FIGURE 3 – Trends in Revenue Sources for Nunavut, 1984–85 to 2005–06



Source: Government of Canada, Statistics Canada, Financial Management System, 2005

The Joint Territorial Submission indicated that while stability and predictability are important characteristics, it is more important that TFF entitlements be responsive to changes in territorial own-source revenues than be stable over time. The submission also indicated that since TFF is the largest revenue source for the territories, TFF grant entitlements need to be adequate and predictable for territorial budgeting purposes.[1]

In reviewing these issues, the Panel focussed on two aspects of TFF: the complex estimation and payment system, and smoothing mechanisms to reduce year-over-year volatility in TFF entitlements. In the Panel's view, one of the benefits of the New Framework was increased stability and predictability of overall TFF funding. However, the stability and predictability of individual entitlements were reduced, since changes in one territory's own-source revenues affected the TFF entitlements of the other territories. In the Panel's view, TFF entitlements for a given territory may be no more stable or predictable under the New Framework than under the previous TFF formula.

The Panel believes that the federal government and the territories would share more equitably in the financial risks of changes in the territorial economies under its new approach. In its view, the financial risk for the territories would be less under their proposal because the new measure of revenues would include only 45 to 67 percent of own-source revenues, at a 70 percent inclusion rate, and exclude other federal transfers.[2] This means that TFF would be responsive to changes in most of the major sources of territorial revenues.

On the issue of the estimates and payment system, the Panel believes that the TFF should be responsive to changes in territorial own-source revenues, provincial-local expenditures and population changes. The Panel recognizes that the principle behind the eight-estimate system is to allow current year entitlements to be based on available data for current year activities, with subsequent estimates revised as more accurate data become available.

Although the Panel recognizes that the TFF estimates and payment system is complex, they do not recommend changing the current process. To ensure that the PAGE escalator remains responsive to relative population changes, estimates of TFF entitlements should be revised until Census population and population undercounts are final. In the Panel's view, a return to a formula-based TFF, coupled with three-year moving averages, should ensure that TFF continues to be responsive to changes in territorial circumstances. A three-year moving average calculation for the PAGE escalator also means that the financial impact of year-over-year changes in the PAGE escalator would be moderated in TFF entitlements.

[1] Government of the Northwest Territories, Government of Nunavut, Government of Yukon. (2005). *Joint Territorial Submission to the Expert Panel on Equalization and Territorial Formula Financing*, p. 7.
[2] This proportion is based on 2005–06 Revised Estimates of revenues for each territory.

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